



# CA FINAL

**ADVANCED AUDITING,  
ASSURANCE & PROFESSIONAL ETHICS**

**PART-2**



**MAKE CA POSSIBLE WITH HD**

**QUESTION BANK POWERED BY  
NAHATA PROFESSIONAL ACADEMY**

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# ACKNOWLEDGEMENT

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I Would Like To ACKNOWLEDGE My Family for  
Their Support Towards My Studies, My career &  
Various Aspects of Life

A special Thank you to My Mentor  
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For constant support, encouragement &  
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## **PART- 2**

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## DIGITAL AUDITING AND ASSURANCE

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**QUESTION:1** Sukanya, a CA final student, is of the view that cyber risks are issues of IT and result only in information loss to an entity. She also feels that many cyber-attacks are not directly targeted at financial systems and do not pose risk of material misstatements to financial statements of an entity. Is her view proper?

**ANSWER:** The cyber risks are not an issue of IT alone. Rather, it is a business risk and has an effect on whole business organization. It affects entity's reputation and can lead to many other consequences which are listed below: -

- Regulatory costs
- Business interruptions causing an operational challenge for an organization.
- Data loss, reputational loss and litigation.
- Ransomware - more common these days where enterprise systems are encrypted
  - Intellectual property theft which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
- Incident response cost which could be for investigations & remediations
- Breach of Privacy, if personal data of a consumer is hacked it could have a significant impact on the organization.
- Fines and penalties

It may happen that many cyberattacks are not directly targeted at financial systems. However, the access gained by the attackers may provide them the ability to:

- Manipulate or modify financial records
- Modify key automated business rules
- Modify automated controls relied upon by the management.

Further, auditor should consider whether cyber risk (like other business risks) represents a risk of material misstatement to the financial statement as part of the audit risk assessment activities. Focus should be on understanding the cyber risks affecting the entity and the actions being taken to address these risks

**QUESTION:2** CA Y is planning to use CAATs extensively in audit of a company-be it for compliance tests or substantive tests. Can you list out examples of few situations (in brief) of tests performed by him using CAATs?

**ANSWER:** (i) **Identify exceptions:** Identify exceptional transactions based on set criteria. For example, cash transactions above ₹ 10,000.

(ii) **Identify errors:** Identify data, which is inconsistent or erroneous. For e.g.: account number which is not numeric.

(iii) Re-perform various computations in audit software to confirm

**Verify calculations:** the results from application software confirm with the audit software. For e.g.: TDS rate applied as per criteria.

(iv) **Existence of records:** Identify fields, which have null values. For example: invoices which do not have vendor name.

(v) **Data completeness:** Identify whether all fields have valid data. For example: null values in any key field such as date, invoice number or value or name.

(vi) **Data consistency:** Identify data, which are not consistent with the regular format. For example: invoices which are not in the required sequence.

(vii) **Duplicate payments:** Establish relationship between two or more tables as required. For example, duplicate payment for same invoice.

(viii) **Accounts exceeding authorized limit:** Identify data beyond specified limit. For example, transactions entered by user beyond their authorized limit or payment to vendor beyond amount due or overdraft allowed beyond limit.

**QUESTION:3** A company is planning to use Robotics process automation (RPA) to streamline its hiring process. Earlier, the company used to hire from campuses of various management institutes leading to high recruitment costs, inefficient hire yield and resultant lack of diversity. How RPA can be used to automate the hiring process? List out tentative few such steps. What could be likely benefits of using RPA in hiring process?

**ANSWER:** RPA can be used to streamline hiring process in a company. The tentative steps could include: -

- Place advertisements on social media/career advice sites.
- Link redirects candidate to a career site.
- Career site pulls information of candidate.
- An algorithm scans applicants for desired and suitable roles.
- Selected candidates may be asked to play online games to assess their skills.
- A certain percentage of those applicants are called for a video interview using an interview software.

The automated hiring process will reduce full time effort involvement, provide with a wider assessment range, reduce the

impact of recruiter biases, increase the efficiency of mapping of interested candidates, reduce recruiting costs, increase hire yield, reduce time to hire, increase diversity

**QUESTION:4** Briefly describe the advantages and challenges of Auditing digitally.

**ANSWER:** Advantages – Improved efficiency, better quality, lower costs, improved risk assessment. Challenges – Reluctance to change, challenges with data security and governance, choosing the right tool and automating the right process, ensuring standardisation and correct configurations to avoid error and bias, evaluating business benefits the organization wants to achieve with automation and the roadmap for digital strategy.

Auditing Digitally is using advancements in technology for conducting an effective and efficient audit. With a rapidly growing IT environment it is essential to adapt technology in auditing practices.

It is time to digitize the way an audit is delivered through automation and innovation. There are new technologies to help ***capture*** data, ***automate*** procedures, ***analyse*** information and ***focus*** on the real risks of the client. The opportunity is in understanding how technology can help and then applying it to the auditing challenges. **OR** REFER TO PARA 2

**QUESTION:5** What are the stages involved in understanding the IT environment and what key considerations auditor should consider?

**ANSWER:** The stages involved in understanding of IT environment are: Understand – Identify – Assess. Key considerations - Understand the flow of transaction, Identification of Significant Systems, Identification of Manual and Automated Controls, Identification of

the technologies used and. Assessing the complexity of the IT environment.

- Understanding the ways in which the entity relies upon IT and how the IT environment is set up to support the business. This allows the auditor to better understand where risks might arise from the entity's use of IT (required as per SA 315).
- Understanding how IT is used by the entity helps in identifying controls over the entity's IT processes.
- Assessing the complexity of the IT environment helps the teams consider whether to involve IT specialists or experts in the planning and/or execution of the audit, including initial consideration of whether to include specialists in the complexity assessment.



The auditor's understanding of the automated environment should include the following:

- The applications that are being used by the company.
- Details of the IT infrastructure components for each of the applications.
- The organization structure and governance.
- The policies, procedures and processes followed.
- Extent of IT integration, use of service organizations.
- IT risks and controls.

**Key Areas for an Auditor to Understand IT Environment are as follows:**

**1. Understand the flow of transactions:** The auditor's understanding of the IT environment may focus on identifying and understanding the nature and number of the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing or storing those transactions or information.

**2. Identification of Significant Systems:** The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.

**3. Identification of Manual and Automated Controls:** An entity's system of internal control contains manual elements and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement.

**4. Identification of the technologies used:** The need to understand the emerging technologies implemented and the role they play in the entity's information processing or other financial reporting activities and consider whether there are risks arising from their use. Given the potential complexities of these technologies, there is an increased likelihood that the engagement team may decide to engage specialists and/or auditor's experts to help understand whether and how their use impacts the entity's financial reporting processes and may give rise to risks from the use of IT.

**QUESTION:6** Auditor should scope in ITGCs to tests when there are IT dependencies identified in the system. Briefly describe the types of IT dependencies.

**ANSWER:** IT Dependencies are created when IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in financial statements.

**There are five types of IT dependencies as described below:**

TYPES	DESCRIPTION
<b>AUTOMATED CONTROL</b>	Automated controls are designed into the IT environment to enforce business rules. For example, Purchase order approval via workflow or format checks (e.g., only a particular date format is accepted), existence checks (e.g., Duplicate customer number cannot exist), and/or reasonableness checks (e.g., maximum payment amount) when a transaction is entered
<b>REPORTS</b>	System generated reports are information generated by IT systems. These reports are often used in an entity's execution of a manual control, including business performance reviews, or may be the source of entity information used by us when selecting items for testing, performing substantive tests of details or performing a substantive analytical procedure. E.g. (Vendor master report, customer ageing report)
<b>CALCULATIONS</b>	Calculations are accounting procedures that are performed by an IT system instead of a person. For example, the system will apply the 'straight-line' depreciation formula to calculate depreciation of an asset (i.e., cost of the asset, less the residual value of the asset at the end of its useful life divided by the useful life of the asset) or the system will calculate the

	value of the amount invoiced to a customer by multiplying the item price times the quantity shipped.
<b>SECURITY</b>	Security including segregation of duties is enabled by the IT environment to restrict access to information and to determine the separation of roles and responsibilities that could allow an employee to perpetrate and conceal errors or fraud, or to process errors that go undetected.
<b>INTERFACES</b>	Interfaces are programmed logic that transfer data from one IT system to another. For example, an interface may be programmed to transfer data from a payroll subledger to the general ledger.

**OR REFER TO PARA 4**

**QUESTION:7** What does cyber risk explain it with some examples.

**ANSWER:** A cyber-attack is an attempt to gain unauthorized access to a computing system or network with the intent to cause damage, steal, expose, alter, disable, or destroy data. Regulators across the globe have placed the topic of cyber risk management under increasing scrutiny, requiring financial institutions to assess the maturity of their cybersecurity program, manage cyber risks, and enhance resiliency against cyber-attacks. Most common types of cyberattacks are:

- **Malware :** Malware or malicious software is any program or code that is created with the intent to do harm to a computer, network or server. Malware is the most common type of cyberattack, its subsets are ransomware, fileless Malware trojans, viruses etc

<b>TYPES</b>	<b>DESCRIPTION</b>
<b>RANSOMWARE</b>	In a ransomware attack, an adversary encrypts a victim's data and offers to provide a decryption key in exchange for a payment. Ransomware attacks are usually launched through malicious links delivered via phishing

	emails, but unpatched vulnerabilities and policy misconfigurations are used as well
<b>FILELESS MALWARE</b>	Fileless malware is a type of malicious activity that uses native, legitimate tools built into a system to execute a cyber-attack. Unlike traditional malware, fileless malware does not require an attacker to install any code on a target's system, making it hard to detect.
<b>TROJAN</b>	A trojan is malware that appears to be legitimate software disguised as native operating system programs or harmless files like free downloads. Trojans are installed through social engineering techniques such as phishing or bait websites.
<b>MOBILE MALWARE</b>	Mobile malware is any type of malware designed to target mobile devices. Mobile malware is delivered through malicious downloads, operating system vulnerabilities, phishing, smishing, and the use of unsecured Wi-Fi.

- **Denial-of-Service (DoS) Attacks** : A Denial-of-Service (DoS) attack is a malicious, targeted attack that floods a network with false requests in order to disrupt business operations. In a DoS attack, users are unable to perform routine and necessary tasks, such as accessing email, websites, online accounts or other resources that are operated by a compromised computer or network. While most DoS attacks do not result in lost data and are typically resolved without paying a ransom, they cost the organization time, money and other resources in order to restore critical business operations.

- **Phishing**: Phishing is a type of cyberattack that uses email, SMS, phone, social media, and social engineering techniques to entice a victim to share sensitive information — such as passwords or account numbers — or to download a malicious file that will install viruses on their computer or phone

TYPES	DESCRIPTION
<b>Spear Phishing</b>	Spear-phishing is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. The goal of spear phishing is to steal sensitive information such as login credentials or infect the targets' device with malware.
<b>Whaling</b>	A whaling attack is a type of social engineering attack specifically targeting senior or C-level executive employees with the purpose of stealing money or information or gaining access to the person's computer in order to execute further cyberattacks.
<b>Smishing</b>	Smishing is a type of fraudulent practice of sending text messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords or credit card numbers.
<b>Vishing</b>	Vishing, a voice phishing attack, is the fraudulent use of phone calls and voice messages pretending to be from a reputable organization to convince individuals to reveal private information such as bank details and passwords.

- **Spoofing:** Spoofing is a technique through which a cybercriminal disguises themselves as a known or trusted source. In so doing, the adversary is able to engage with the target and access their systems or devices with the ultimate goal of stealing information, extorting money or installing malware or other harmful software on the device.

TYPES	DESCRIPTION
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<b>Domain Spoofing</b>	Domain spoofing is a form of phishing where an attacker impersonates a known business or person with a fake website or email domain to fool people into trusting them. Typically, the domain appears to be legitimate at first glance, but a closer look will reveal subtle differences.
<b>Email Spoofing</b>	Email spoofing is a type of cyberattack that targets businesses by using emails with forged sender addresses. Because the recipient trusts the alleged sender, they are more likely to open the email and interact with its contents, such as a malicious link or attachment.

- **Identity-Based Attacks** : When a valid user's credentials have been compromised and an adversary pretends to be that user. For e.g., people often use the same user ID and password across multiple accounts. Therefore, possessing the credentials for one account may be able to grant access to other, unrelated accounts.
- **Insider Threats** : When current or former employees pose a danger to an organization because they have direct access to the company network, sensitive data, and intellectual property (IP), as well as knowledge of business processes, company policies, or other information that would help carry out such an attack.
- **DNS Tunneling** : DNS Tunneling is a type of cyberattack that leverages domain name system (DNS) queries and responses to bypass traditional security measures and transmit data and code within the network. This tunnel gives the hacker a route to unleash malware and/or to extract data, IP, or other sensitive information by encoding it bit by bit in a series of DNS responses.
- **IoT-Based Attacks**: An IoT attack is any cyberattack that targets an Internet of Things (IoT) device or network. Once compromised, the

hacker can assume control of the device, steal data, or join a group of infected devices

**QUESTION:8** Briefly describe the cyber security Framework.

**ANSWER:** Cybersecurity framework includes how management is identifying the risk, protecting and safeguarding its assets (including electronic assets) from the risk. Management preparedness to detect the attacks, anomalies and responsiveness to the adverse event

**1. Identify the risk:** Auditor has to determine whether the entity's risk assessment process considers cybersecurity risks. Entity should conduct a periodic risk assessment & develop a management strategy which identifies cybersecurity risks around IT system failure affecting the entity's primary business or potential loss of data or inability to access data as required, Risk of unauthorized access to the IT network. The entity should maintain and periodically reviews an inventory of their information assets- i.e., Asset Management (e.g., intellectual property, patents, copyrighted material, trade secrets and other intangibles). The entity should classify and prioritize protection of their information assets based on sensitivity and business value and periodically reviews the systems connected to the network on which digital assets reside.

From the governance perspective management should review how cybersecurity risks affect internal controls over financial reporting. In case of adverse attack how management is going to assess the impact on the recoverability of financial data and impact on revenue recognition. Management needs to identify if any established a risk-based cybersecurity program can be leveraged e.g. (NIST, ISO etc.) To determine overall responsibility for cybersecurity in the business environment entity should establish roles and responsibilities over cybersecurity (CISO, CIO). Further the risk assessment should be

discussed with those charged with governance (e.g., the Audit Committee or Board of Directors).

**2. Protect the risk** Obtained an understanding of the entity's processes for safeguarding of assets subject to cybersecurity. Entity monitors whether there has been unauthorized access to electronic assets and any related impact on financial reporting.

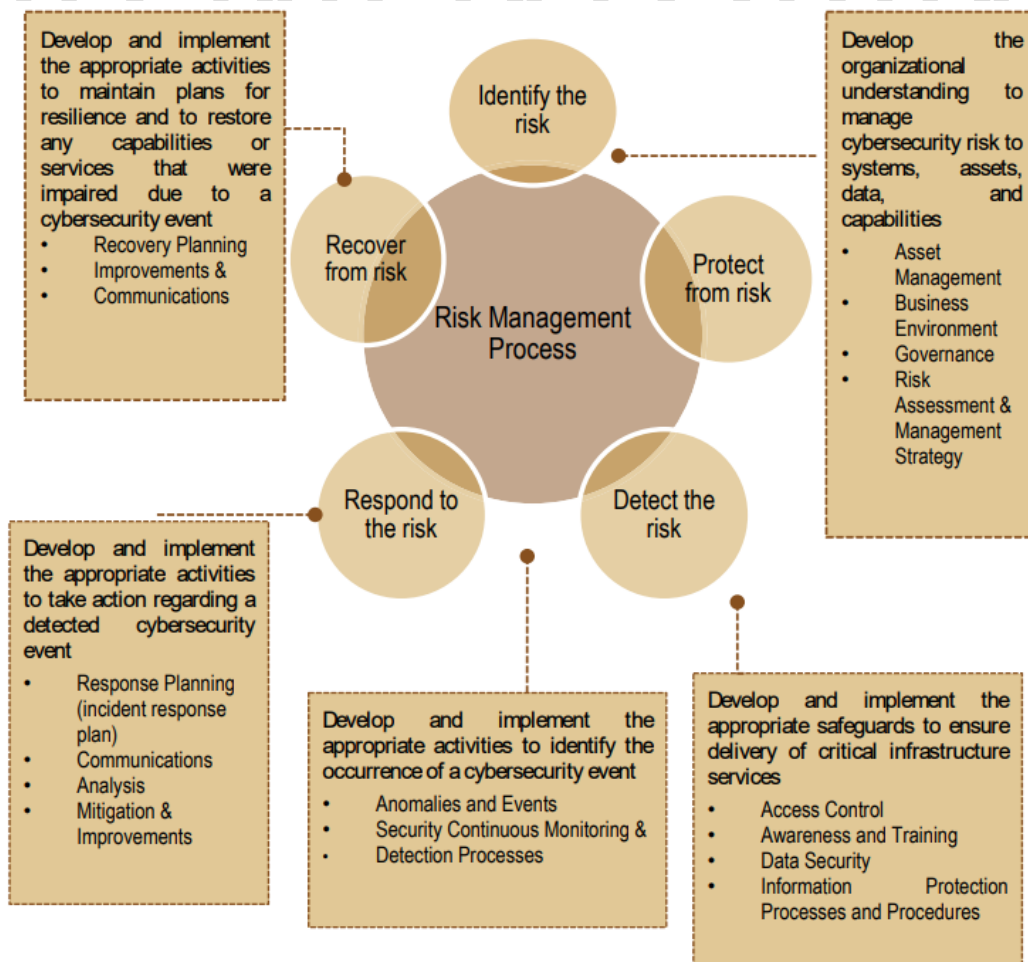
Formal training should be conducted to make the teams aware of the risk associated with cyberattacks. Entity should implement effective controls for data security. Entity should have a process & procedures in place for identifying material digital/electronic assets on the balance sheet subject to cybersecurity risk (e.g., intellectual property, patents, copyrighted material, trade secrets) and prioritizing their protection based on criticality.

**3. Detect The risk** Entity should have controls and procedures that enable it to identify cybersecurity risks and incidents and to assess and analyse their impact on the entity's business, evaluate the significance associated with such risks and incidents, and consider timely disclosures. Review entity's processes to monitor and detect security breaches or incidents. If management has implemented anti-virus in the system to secure it from anomalies or if firewall logs are being continuously monitored to detect any repetitive attacks. A monitoring process should be established to review how many such events have been denied by the firewall. Monitoring process should also include if any upgrades or updates are required to safeguard the systems from vulnerabilities.

**4. Respond to the risk** In case of material cybersecurity or data breach has been identified management should capture the details of nature of incident and how the incident or data breach was identified. Entity should have a response planning in place to capture the details of nature of incident and the same needs to be communicated with those who are ultimately responsible for this

framework and with those charge with governance. The security incident response plan helps in analysing the impact and severity of the at ack and helps the organisat on in taking the appropriate act ons. Management should assess Lit gat on costs, Regulatory invest gat on costs and Remediat on costs as a part of mit gat on process and improvement management should assess the future act on plans that needs to be taken to safeguard the organisat on from such at acks.

**5. Recover from risk** Ent ty should undertake appropriate act ons to recover from the at ack and make sure the business is up and running. Once the impact evaluated and communicated with the regulators the recovery plan needs to be implemented to overcome the impact. Necessary improvements – like patch upgrades, bet er controls, improved technology in terms of f rewall, ant -virus, tools etc needs to be implemented to safeguard the ent ty



**QUESTION:9** What are the advantages and disadvantages of remote audit?

**ANSWER:** Advantages and Disadvantages of remote audit:

ADVANTAGES	DISADVANTAGES
Cost and time effective: No travel time and travel costs involved.	Due to network issues, interviews and meetings can be interrupted.
Comfort and flexibility to the audit team as they would be working from home environment,	Limited or no ability to visualize facility culture of the organization, and the body language of the auditees. Time zone issues could also affect the efficiency of remote audit session
Time required to gather evidence can spread over several weeks, instead of concentrated into a small period that takes personnel from their daily activities.	The opportunity to present doctored documents and to omit relevant information is increased. This may call for additional planning, some additional/different audit procedures, Security and confidentiality violation.
Auditor can get first-hand evidence directly from the IT system as direct access may be provided.	Remote access to sensitive IT systems may not be allowed. Security aspects related to remote access and privacy needs to be assessed
Widens the selection of auditors from global network of experts.	Cultural challenges for the auditor. Lack of knowledge for local laws and regulations could impact audit. Audit procedures like

	<b>physical verification of assets and stock taking cannot be performed.</b>
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**QUESTION:10** In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for preparation of management information system (MIS) reports and electronic dashboards that give a high level snapshot of business performance. In view of above you are required to briefly discuss the meaning of data analytics and example of such data analytics techniques.

**ANSWER:** Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics. Audit analytics or audit data analytics involves analyzing large sets of data to find actionable insights, trends, draw conclusions and for informed decision making. The use of audit analytics enables greater efficiencies and more accurate findings from the review process.

As a result, businesses will be able to create strategies based on verifiable data and professional assumptions and auditors can improve the audit quality. It allows auditors to more effectively audit the large amounts of data held and processed in IT systems in larger clients.

- To discover and analyze patterns
- Identifying anomalies
- Extract other useful information in data

The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. It involves use of multiple data analytical tool or visualization tools that can help the auditor to deep dive into the problem statement and hence

increase the audit quality. This also minimizes the scope of missing out on key attributes that might be of a higher risk to the organization and its respective business.

Auditor performing audit analytics can make use of various applications and tools that help them to analyse large data sets and obtain insights that help them to make the quality of the audit better. Some of the popular tools used across the industry as part of CAATs are listed below:

- 1. ACL - Audit Command Language (ACL) Analytics** is a data extraction and analysis software used for fraud detection and prevention, and risk management. It samples large data sets to find irregularities or patterns in transactions that could indicate control weaknesses or fraud.
- 2. Alteryx** - Alteryx is used to consolidate financial or operational data to assess controls. A fully transparent audit trail of every action is performed in Alteryx in form of a workflow which makes it easier for the user to learn as no prior knowledge of coding or scripting is required. Alteryx can also be leveraged to automate analytics and perform Machine Learning to search for patterns indicative of fraud or irregularities speed up your processes like accounting close, tax filings, regulatory reporting, forecast creation etc. It can also be used to automate set procedures that are performed periodically like reconciliations, consolidations, marketing workflows, system integrations, continuous audits etc.
- 3. Power BI** – Power BI is a business intelligence (BI) platform that provides nontechnical business users with tools for aggregating, analyzing, visualizing and sharing data. From audit perspective, such visualization tools can be used to find the outliers in the population, it can also be used for reporting purpose (audit reports) in an interactive dashboard to the higher management.

**4. CaseWare** – CaseWare is a data analysis software & provides tools that help in conducting audit and assurance engagements quickly, accurately and consistently. It shares analytical insights which help in taking better informed decisions. It helps in streamlining processes and eliminating the routine tasks. Used by accounting firms, governments and corporations worldwide, this trusted platform integrates everything you need to conduct assurance and reporting engagements.

**QUESTION:11** Enterprises are adopting emerging technologies at a rapid pace to create synergies and harness the latest technologies. Give 3 examples of automated tools used as a part of emerging technologies along with the risk and audit considerations associated with these tools.

**ANSWER:** Enterprises are adopting emerging technologies at a rapid pace to create synergies and harness the latest technologies.

Robotic process automation (RPA), blockchain, machine learning, Internet of Things (IOT) and artificial intelligence (AI) are some prime examples of automation.

Automation and use of technology often requiring auditors to understand and perform procedures on a larger group of systems that produce information relevant to the production of financial statements.

Based on management and auditors' independent risk assessment procedures, the audit's scope may need to include peripheral systems, as well as testing general IT and application controls relative to those systems due to the increased use of technology that is relevant to financial reporting.

**OR**

REFER TO PARA 7

**QUESTION:12** Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks. Give some examples of technology risks of digital system and the control considerations to consider while assessing technology risk.

**ANSWER:-** Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks.

The strength of the auditing profession is the assessment of risks and controls. As they address the challenge of assessing technology risk, auditors can and should focus on the following control considerations:

1. Auditors should gain a holistic understanding of changes in the industry and the information technology environment to effectively evaluate management's process for initiating, processing, and recording transactions and then design appropriate audit procedures.

2. Auditors, as appropriate, should consider risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional, legacy systems.

3. Auditors should consider whether digital upskilling or specialists are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.

**Some examples of technology risks where auditors should test the appropriate controls for relying on the digital systems**

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both

- Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database)
- The possibility of information technology personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby leading to insufficient segregation of duties
- Unauthorized or erroneous changes to data in master files
- Unauthorized changes to systems or programs
- Failure to make necessary or appropriate changes to systems or programs
- Inappropriate manual intervention
- Potential loss of data or inability to access data as required
- Risks introduced when using third-party service providers
- Cybersecurity risks

**OR** Refer to para 8

**QUESTION:13** Give example of emerging technologies available for Next Generation Audit along with the risks associated with it.

**ANSWER:-**The Next Generation Audit is human-led, tech-powered and data-driven. It is based on combining emerging technologies to redefine how audits are performed.

Next Generation Audit aims to the following:



We live in an era of fast technological progress, with new digital devices, applications, and tools being developed almost on a daily basis. 3D printing, augmented reality (AR) and virtual reality (VR), biotechnology, auditing through drones (also known as an 'Unmanned Aerial Vehicle' (UAV) and quantum technology are some of the most rapidly advancing areas, with many implications for society.

HD MENTORING

**GROUP AUDITS****13**

**QUESTION:1** CA. Mukund is in the second year of his term as statutory auditor of Style Marks Limited (Holding company), its subsidiaries and joint ventures. At the time of planning audit, he wants to be sure that all the components have been included in the consolidated financial statements. List out some procedures he should perform to verify completeness of this information.

**ANSWER:-** The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion. In respect of completeness of this information, the auditor should perform the following procedures:

- (a) review his working papers for the prior years for the known components
- (b) review the parent's procedures for identification of various components
- (c) make inquiries of management to identify any new components or any component which goes out of consolidated financial statements
- (d) review the investments of parent as well as its components to determine the shareholding in other entities
- (e) review the joint ventures and joint arrangements as applicable
- (f) review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group

(g) review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013

(h) also identify the changes in the shareholding that might have taken place during the reporting period.

**QUESTION:2** CA. Kajal is nearing completion of audit of consolidated financial statements of Rubic Paints and Chemicals Limited. She requires written representations from the parent's management on matters material to the consolidated financial statements. What specific matters such written representations can include?

**ANSWER:-** The auditor of the consolidated financial statements should obtain written representations from parent's management on matters material to the consolidated financial statements. Examples of such representations include:

- (a) Completeness of components included in the consolidated financial statements;
- (b) Identification of reportable segments for segment reporting
- (c) Identification of related parties and related party transactions for reporting
- (d) Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions.

**QUESTION:3** CA.M is auditor of consolidated financial statements of "D and D Limited" for year 2022-23. The consolidated financial statements consist of financial statements and financial information of 8 subsidiaries audited by other auditors. Such financial statements, financial information and auditor's reports of subsidiaries have been furnished by management of the "D and D Limited" to him. Following

further information is also available in respect of these 8 subsidiaries for year 2022-23: -

Total assets ` 1500 crore

Total revenues ` 1000 crore

Net cash out flows ` 10 crore

Two of these subsidiaries are located outside India whose financial statements have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries.

Where and how such information should be included in independent auditor's report on consolidated financial statements of company? Also draft a suitable para by making necessary assumptions.

**ANSWER:-** In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, then as prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditors. This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor. It should be included in Other Matter paragraph of independent auditor's report. The draft "Other Matter Paragraph" is as under: - Other Matter Paragraph We did not audit the financial statements and other financial information, in respect of eight (8) subsidiaries, whose financial statements include total assets of Rs.1500 crores as at March 31, 2023, and total revenues of Rs.1,000 crores and net cash out flow of Rs. 10 crores for the year ended on that date. These financial

statements and other financial information have been audited by other auditors and such financial statements, other financial information and auditor's reports have been furnished to us by the management of the Holding Company. Our opinion on the consolidated financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and joint ventures, and our report in terms of sub-sections (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries is based solely on the reports of such other auditors. Two of these subsidiaries are located outside India whose financial statements and other financial information have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries. The Holding Company's management has converted the financial statements of such subsidiaries from accounting principles generally accepted in their respective countries to accounting principles generally accepted in India. We have audited these conversion adjustments made by the Holding Company's management. Our opinion in so far as it relates to the balances and affairs of such subsidiaries is based on the report of other auditors and the conversion adjustments prepared by the management of the Holding Company and audited by us. Our opinion on the consolidated financial statements, and our report on Other Legal and Regulatory Requirements is not modified in respect of the above matters with respect to our reliance on the work done and the reports of the other auditors and the financial statements and other financial information certified by the Management.

**QUESTION:4** Whether preparation of consolidated financial statements is mandatory? If yes, please elaborate on the requirements under the statute.

**ANSWER:-** According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Further, section 129(4) of the said Act, provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to its consolidated financial statements. The consolidated financial statements shall also be approved by the Board of Directors before they are signed on behalf of the Board, along with its standalone financial statements and shall also be laid before the annual general meeting of the company along with the laying of its standalone financial statement. The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary(ies) in Form AOC-1. According to the Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act

However, the requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:

(i) it is a wholly-owned subsidiary, or is a partly-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated

(ii) it is a wholly-owned subsidiary, or is a partly-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated

(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

As per sub-section 6 of section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification. Thus, the companies having subsidiaries, which have previously never prepared the consolidated financial statements, must prepare their consolidated financial statements in adherence with this mandatory requirement. This will provide the holding companies' stakeholders more transparency about the companies' businesses. Further, an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

**QUESTION:-5** . Please elaborate on the situations wherein the requirement related to preparation of consolidated financial statements may not apply.

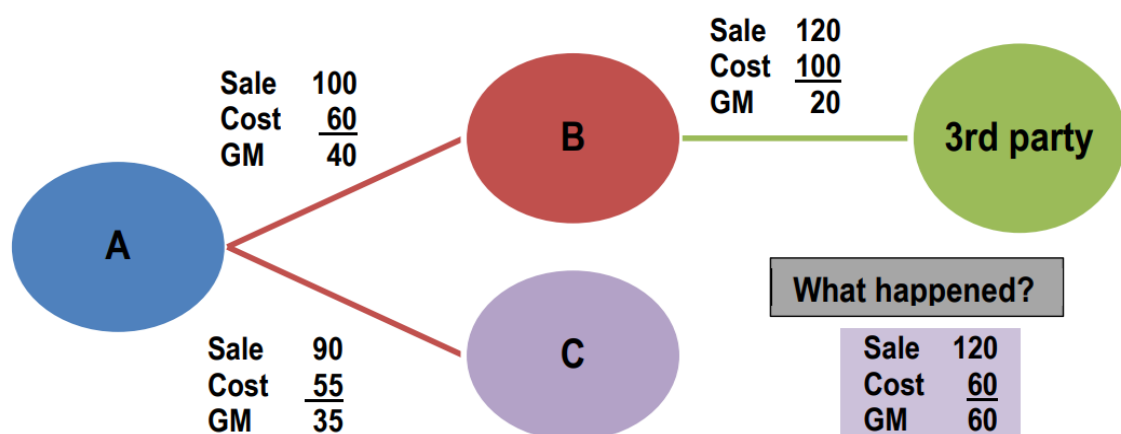
**ANSWER:-** The requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:

- (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
- (ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
- (iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards

**QUESTION:-6** While doing the audit of Consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?

**ANSWER:-** Current period adjustments are those adjustments that are made in the accounting period for which the consolidation of financial statements is done.

**Consolidation – Elimination of inter-company purchases as sales**



Current period consolidation adjustments primarily relate to the elimination of intra-group transactions and account balances including:

- (a)** intra-group interest paid and received, or management fees, etc.;
- (b)** unrealised intra-group profits on assets acquired/ transferred from/ to other subsidiaries;
- (c)** record deferred taxes on unrealised intercompany profits elimination in accordance with Ind AS 12;
- (d)** intra-group indebtedness;
- (e)** adjustments related to harmonising the different accounting policies being followed by the parent and its components;
- (f)** adjustments to the financial statements (of the parent and the components being consolidated) for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the consolidated financial statements of the group.

**There are two types of subsequent events:**

- (i)** The first type of subsequent events consists of events or transactions that provide additional evidence about conditions that existed at the date of the financial statements, including the estimates inherent in the process of preparing financial statements (i.e. adjusting events).
- (ii)** The second type of subsequent events consists of events that provide evidence about conditions that did not exist at

the date of the financial statements but arose subsequent to that date (i.e. non-adjusting events).

Events occurring after balance sheet date which do not require adjustments would not normally require disclosure, although they may be of such significance that they may require a disclosure in the report of approving authority in the case of accounting standards and in the financial statements in case of Ind AS. For such events, the following shall be disclosed:

- (i)** The nature of the event; and
- (ii)** An estimate of its financial effect or a statement that such an estimate cannot be made.

**(g)** adjustments for the effects of significant transactions or other events that occur between the date of the component's balance sheet and not already recognised in its financial statements and the date of the auditor's report on the group's consolidated financial statements when the financial statements of the component to be used for consolidation are not drawn up to the same balance sheet date as that of the parent;

**(h)** In case of a foreign component, adjustments to convert a component's audited financial statements prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared;

**(i)** determination of movement in equity attributable to the minorities interest/non-controlling interest since the date of acquisition of the subsidiary. It should also be noted that under Ind AS, non-controlling interest can also result in negative balance. Unlike earlier AS, as per paragraph 28 of Ind AS 27, if the net worth of subsidiary is negative, non-controlling interest could have deficit balance;

**(j)** adjustments of deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intragroup transactions and undistributed profits of the component in case of consolidated financial statements prepared under Ind AS.

The adjustments required for preparation of consolidated financial statements are made in memorandum records kept for the purpose by the parent. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements. purpose by the parent. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements.

**QUESTION:-7 .** Write a short note on:

**(a)** Responsibility of holding company for preparation of Consolidated Financial Statements.

**(b)** Permanent Consolidated Adjustments.

**ANSWER:- (a)** The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent. This includes:

**(a)** identifying components, and including the financial information of the components to be included in the consolidated financial statements;

**(b)** where appropriate, identifying reportable segments for segmental reporting;

**(c)** identifying related parties and related party transactions for reporting;

(d) obtaining accurate and complete financial information from components;

(e) making appropriate consolidation adjustments;

(f) harmonization of accounting policies and accounting framework; and

(g) GAAP conversion, where applicable.

Apart from the above, the parent ordinarily issues instructions to the management of the component specifying the parent's requirements relating to financial information of the components to be included in the consolidated financial statements. The instructions ordinarily cover the accounting policies to be applied, statutory and other disclosure requirements applicable to the parent, including the identification of and reporting on reportable segments, and related parties and related party transactions, and a reporting timetable.

(b) Permanent consolidation adjustments are those adjustments that are made only on the first occasion or subsequent occasions in which there is a change in the shareholding of a particular entity which is consolidated. Permanent consolidation adjustments are:

**(a) Determination of goodwill or capital reserve as per applicable accounting standards.**

**(b) Determination of amount of equity attributable to minority/non-controlling interests**

The auditor should verify that the above calculations have been made appropriately.

◆ The auditor should pay particular attention to the determination of pre-acquisition reserves of the components. Date(s) of investment in components assumes importance in this regard.

◆ The auditor should also examine whether the pre-acquisition reserves have been allocated appropriately between the parent and the minority interests/ non-controlling interests of the subsidiary.

◆ The auditor should also verify the changes that might have taken place in these permanent consolidation adjustments on account of subsequent acquisition of shares in the components, disposal of the components in the subsequent years.

It may happen that while working out the permanent consolidation adjustments, in the case of one subsidiary, goodwill arises and in the case of another subsidiary, capital reserve arises. The parent may choose to net off these amounts to disclose a single amount in the consolidated balance sheet where permitted by the applicable financial reporting framework. In such cases, the auditor should verify that the gross amounts of goodwill and capital reserves arising on acquisition of various subsidiaries have been disclosed in the notes to the consolidated financial statements to reflect the excess/shortage over the parents' portion of the subsidiary's equity.

**QUESTION: 8** R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?

**ANSWER:-** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case. Paragraph 20 of Ind AS 110

states that “Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee”. However, as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act. In the given case, R Ltd’s intention is to dispose of the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is temporary, Therefore, R Ltd. is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for ‘temporary control’ is not available under Ind AS 110.

**QUESTION:-9** A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd., what factors would be considered by you as the statutory auditors of A Ltd for the audit of its consolidated financial statements prepared under Ind AS?

**ANSWER:-** 10% Voting Power and Control over the composition of Board of Directors: In this case, A Ltd. holds only 10 percent of the voting power but has control over the composition of the Board of Directors of B Ltd. In such a case, A Ltd shall be considered as a parent of B Ltd and, therefore, it would consolidate B Ltd in its consolidated financial statements as a subsidiary. The auditor should verify A Ltd’s management’s assessment of having control in B Ltd despite having only 10% voting power as per the requirements of Ind AS 110. Auditor would need to verify as to how A Ltd controls the composition of the Board of Directors or corresponding governing body of B Ltd.. There can be various means by which such kind of control can be established. In this regard, the auditor may verify the

minutes of Board meetings, shareholder agreement entered into by the parent, agreements with B Ltd to which the parent might have provided any technology or know how, enforcement of statute, etc. Further, the auditor should verify that the adjustments warranted by Ind AS 110 have been made wherever required and have been properly authorised by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments. The auditor should make plan, among other things, for the understanding of accounting policies of the A Ltd and B Ltd and determining and programming the nature, timing, and extent of the audit procedures to be performed etc. Further, the duties of an auditor with regard to reporting of transactions with any other related parties are given in SA 550 on Related Parties. As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity are considered as Related Party. In forming an opinion on the financial statements, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with Ind AS 110 and Schedule III and whether the effects of the related party relationships and transactions prevent the financial statements from achieving true and fair presentation (for fair presentation frameworks) or cause the financial statements to be misleading (for compliance frameworks)

**QUESTION:-10.** You are appointed as an auditor of Nawab Limited, a listed company who is a main supplier to the UK building and construction market. With a turnover of 2.9 billion, the company operates through 11 business units and has nearly 180 branches

across the countries. As an auditor, how will you draft the report in case:

**(a)** When the Parent's Auditor is also the Auditor of all its Components?

**(b)** When the Parent's Auditor is not the Auditor of all its Components?

**(c)** When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent?

**(d)** When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?

**(e)** Where the financial statements of one or more components is not audited?

**ANSWER:-(A) While drafting the audit report, the auditor should report:**

◆ Whether principles and procedures for preparation and presentation of consolidated financial statements as laid down in the relevant accounting standards have been followed. In case of any departure or deviation, the auditor should consider the requirements given in SA 705, Modifications to the Opinion in the Independent Auditor's reports in the audit report so that users of the consolidated financial statements are aware of such deviation.

◆ Auditor should issue an audit report expressing opinion whether the consolidated financial statements give a true and fair view of the state of affairs of the Group as on balance sheet date and as to whether consolidated profit and loss statement gives true and fair view of the results of consolidated profit or losses of the Group for the period under audit.

◆ Where the consolidated financial statements also include a cash flow statement, the auditor should also give his opinion on the true and fair view of the cash flows presented by the consolidated cash flow statements.

### **(B) When the Parent's Auditor is also the Auditor of all its Components**

In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of SA 600

As prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor. Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidation adjustments. Reference in the report of the auditor on the consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its subsidiaries

### **(C) When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent**

The parent may have components located in multiple geographies outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its financial statements. Foreign components prepare financial statements under different financial reporting frameworks, which may be a well-known framework (such as US GAAP or IFRS) or the local GAAP of the jurisdiction of the component. Local component auditors may be unable to report on financial statements prepared using the parent's GAAP because of their unfamiliarity with such GAAP. When a component's financial statements are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's consolidated financial statements, the parent's management perform a conversion of the components' audited financial statements from the framework used by the component to the framework under which the consolidated financial statements are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation. A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies". When applying the approach of using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group

accounting policies with the GAAP applicable to the parent's financial statements. This ensures that the information prepared under the requirements of the group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements.

**(D) When the Component(s) Auditor Reports under an Audit Framework Different than that of the Parent?**

Normally, audits of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India ("Indian GAAS"). In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the consolidated financial statements, the components' financial statements should also be audited under a framework that corresponds to Indian GAAS.

**(e) Where the financial statements of one or more components is not audited?**

Generally, the financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi-location group audit. Such audits and audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components' auditor. Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the

consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

**QUESTION:-** 11 M Ltd. acquired 51 % shares of S Ltd. on 01-04-2019 and sold 25% of these shares during the financial year 2019-20. M Ltd. did not prepare Consolidated Financial Statements for the financial year 2019-20 on the plea that the control was only temporary. Do you agree with the view of M Ltd.? Decide, assuming, that M Ltd. is required to prepare its financial statements under Ind AS.

**ANSWER:-** Consolidation of Financial Statement: As per Ind AS 110, there is no such exemption for 'temporary control', or "for operating under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case. Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee". In the given case, M Ltd acquired 51% shares of S Ltd on 01.04.2019 and sold 25% shares during the year ended 2019-20. M Ltd did not consolidate the financial statements of S Ltd for the year ended 31.03.2020 on the plea that control was only temporary. The intention of M Ltd. is quite clear that the control in S Ltd. is temporary as the former company disposed of the acquired shares in the same year of its purchase. However, even though the intention of M Ltd. is for temporary holding of shares in S Ltd. as per Ind AS, M Ltd is required to prepare

Consolidated Financial Statements in accordance with Ind AS 110 as exempt on for 'temporary control' is not available under Ind AS 110. However, "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee". Here, due to sale of investment in S Ltd. up to 25%, M Ltd. loses control of S Ltd. Accordingly, M Ltd., is required to prepare consolidated statement till the date of disposal of the 25% shares to comply with the same.

**QUESTION:-**12 H Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your views

**ANSWER:-** Consolidated Financial Statements: According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to

prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act. However, an investment entity need not present consolidated financial statements if it is required, in accordance with Ind AS 110 'Consolidated Financial Statements', to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity. (An investment entity is an entity that (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.) In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act. Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated, then list should be disclosed in notes to accounts with reason.

**QUESTION:-13.** Venus Ltd. is a company engaged in the manufacture of stainless steel items. The company operates through 5 business units and has 35 branches across India. Manglam & Associates are being appointed as the principal auditor of the company. While

accepting the audit assignment as the principal auditor, what will be the points of consideration for the principal auditor of the company?

**ANSWER:- Acceptance as Principal Auditor :**The principal auditor, Manglam & Associates, should consider whether their own participation is sufficient to be able to act as the principal auditor. For this purpose, the auditor would consider:

- (a) the materiality of the portion of the financial information which the principal auditor audits;
- (b) the principal auditor's degree of knowledge regarding the business of the components;
- (c) the risk of material misstatements in the financial information of the components audited by the other auditor; and
- (d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

**QUESTION:-14.** Venus Ltd. is a certain manufacturing company having its corporate office in Punjab. The company is in the process of expansion and has acquired four companies during the year. Pradyuman & Co. is the principal auditor of the company while the audit of all the companies acquired during the year is being conducted by Jha & Jha Associates. During the course of audit, CA Pradyuman, the engagement partner asked the management of Venus Ltd. at the corporate office that in order to conduct the audit of the consolidated financial statements, his audit firm is required to conduct audit of the financial statements of all the components also (Companies acquired during the year). To this, the management asked CA Pradyuman to consider the audit reports of the component auditor already provided to his audit team and to communicate with

the component auditor for any discussion they wish to have. CA Pradyuman contended that for the purpose of audit of consolidated financial statements either his firm is required to conduct an audit of all the component's financial statements or he needs the working papers of the component auditors. Is the content on of CA Pradyuman correct?

**ANSWER:-** As per SA 600, "Using the work of Another auditor", the principal auditor is normally entitled to rely upon the work of component auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

The principal auditor should consider the significant findings of the other auditor.

The principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial

information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor. Accordingly, CA Pradyuman, can perform the above mentioned audit procedures. However, the audit of the component's financial statements by the principal auditor is not required. So, the

content on of CA Pradyuman that for the purpose of audit of consolidated financial statements he is required to conduct an audit of the components financial statements is not correct. Further, SA 230 issued by ICAI on Audit Documentat on, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specif ed by law or regulat on, audit documentat on is the property of the auditor. He may at his discret on, make port ons of, or extracts from, audit documentat on available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel. Accordingly, it is the discret on of the component auditor as the working papers with respect to the components examined by the component auditor are the property of the component auditor. So, the content on of CA Pradyuman is not correct.

**QUESTION:-15** Kukreja & Associates is the principal auditor of MN Ltd. The company is engaged in the manufacture of sports items and operates through its 14 branches all over India. With respect to the audit of branches, the company has appointed seven Chartered Accountant f rms, each f rm conduct ng the audit of two branches. The audit reports in respect of accounts of branches have already been sent to the principal auditor. While analysing the work of the branch auditors, CA Kukreja, the engagement partner, asked the branch auditors to share with him a summary of the audit procedures and f ndings in respect of the accounts of the branches examined by them. CA Kukreja also asked one of the branch auditor to share his working paper with respect to the two branches examined by that branch auditor for his review and return. Is the principal auditor correct in asking the branch auditors for sharing the summary and the working papers for his review.

**ANSWER:-** In terms of SA 600 "Using the Work of Another auditor", where another auditor has been appointed for the component, the

principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India. The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.

Accordingly, CA Kukreja is correct in asking the branch auditors to share with him the summary of their audit procedures and findings in respect of the accounts of the branches examined by them. Further, CA Kukreja has asked one of the branch auditors to share with him the working papers with respect to the branches examined by such branch auditor for the former's review and return. SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel. Accordingly, it is the discretion of the branch auditor as the working papers with respect to the branches examined by the branch auditor are the property of the branch auditor. So, CA Kukreja is not correct in asking the branch auditor to share with him the

working papers with respect to the branches examined by the branch auditor.

# HD MENTORING

## SPECIAL FEATURES OF AUDIT OF BANKS & NON-BANKING FINANCIAL COMPANIES

# 14

**QUESTION:-**1 CA. Harshit is conducting statutory audit of branch of a public sector bank. On examining 20 large advances of the branch, he finds that in 5 examined cases, loan applications have been filled up scantily with important details left out. In these cases, it is also noticed that cash credit limits to the borrowers were enhanced during the year but there are no records pertaining to assessment of enhanced working capital requirements in respect of borrower files. The branch is unable to show such assessments/workings in system either. However, all the five accounts are operating satisfactorily. These accounts have been classified as standard assets by branch. Would above information prompt auditor to suggest change in asset classification of above accounts? What does depicted situation reflect?

**ANSWER:-** NBFC-P2P falls in base layer in accordance with scale-based regulations of RBI. Few audit procedures for NBFC-P2P are as under: -

- Gaining an understanding of business conducted by NBFC-P2P. It should be verified that company undertakes only permissible activities applicable to such type of NBFCs like providing online marketplace to participants for lending and borrowing. It should not be engaged in business of lending funds on its own.
- Verifying certificate of registration obtained from RBI for carrying business of P2P platform.

- Verifying Board approved policy setting out eligibility criteria for participants i.e lenders and borrowers.
- Verifying board approved policy for pricing of services provided by P2P platform
- Verification of adherence to lending and borrowing guidelines prescribed by RBI
- Verifying appropriate arrangements have been entered into among participants and NBFC-P2P.
- Compliance with reporting requirements of RBI
- Verifying board approved policy for grievance redressal and complaints

**QUESTION :-2** You are conducting concurrent audit of branch of a public sector bank. It is a large branch having advances of about ₹ 500 crores including export advances of ₹ 300 crores. Some borrowers also get LCs issued from branch for importing raw diamonds from diamond hubs of Belgium. You want to be sure that there is no revenue leakage in branch. For the time being, you are focusing upon advances. Discuss any five areas pertaining to advances of the branch which you would verify to ensure no revenue leakage

**ANSWER:-**The said company is not identified in upper layer by RBI. Under scale based regulations introduced by RBI, NBFCs undertaking housing finance activities constitute "middle layer". The asset size is not relevant in such a case. All housing finance companies not identified in upper layer would constitute middle layer due to nature of such activities undertaken by them. There is specific reporting requirement under CARO, 2020 under clause 3 (xvi)(b) which requires auditor to report whether the company has conducted any non-Banking financial or housing finance activities

without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.

**QUESTION :-3** CA. Seema is appointed as stock auditor of Bhawani Rice Mills Pvt. Ltd. availing credit facilities from R.K. Puram Branch, Near Tamil Educational Society, New Delhi. The borrower is enjoying cash credit limit of ₹ 12 crore from branch against security of paid stocks and debtors up to 90 days against margin of 25%. She proceeds to visit premises of Bhawani Rice Mills Pvt. Ltd. located on outskirts of Delhi. She verifies books of accounts and stock records of the company and also test checks quantity of paddy and rice of 20000 quintals and 8000 bags lying in premises of the company. Drawing power of ₹ 12.05 crore is computed in stock audit report and report stands submitted to bank. After about a week, regular internal inspector appointed by Inspection department of bank also happened to visit premises of the borrower and found that rice contained in about 5000 bags included in stocks having approx. value of ₹ 1.50 crore was fungus ridden. The company was holding this stock for last 15 months. How do you view the above situation? Discuss.

**ANSWER:-** An NBFC is preparing financial statements in accordance with requirements of Division III of Schedule III of Companies Act, 2013 has to separately disclose by way of note any item of “other expenditure” exceeding 1% of total income. The said expenditure of ₹99.50 crore does not exceed 1% of total income. Hence, it meets requirements of Division III of Schedule III of Companies Act, 2013.

**QUESTION :-4** Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. Your Audit Manager informed that the bank has recognised on accrual basis income from dividends on securities

and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year. Comment.

**ANSWER:** Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This is also in accordance with AS 9. In this case the dividends have been declared after the financial year end. Therefore, the recognition of income by the bank on accrual basis is not in order. In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government

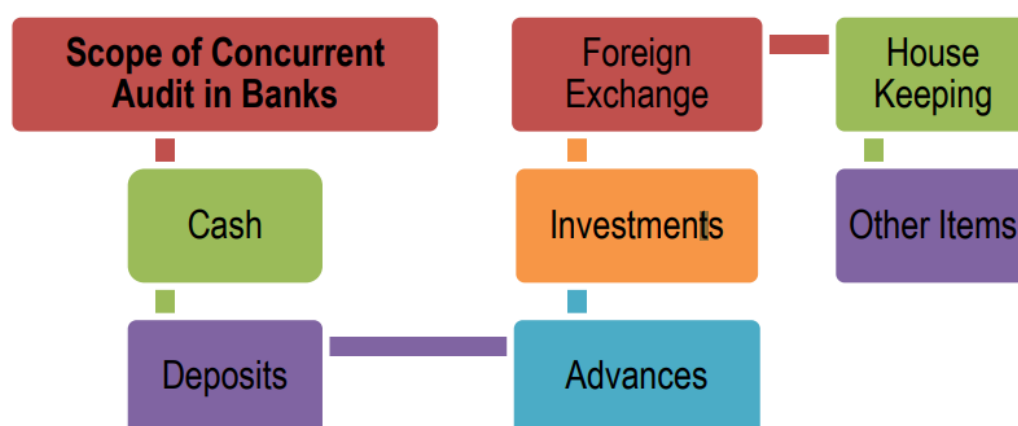
**QUESTION:-5** As statutory central auditors of a Nationalized bank, what special points are to be borne in mind in the audit of compliance with "Statutory Liquidity Ratio" (SLR) requirements?

**ANSWER:- Statutory Liquidity Ratio (SLR) Requirements** -SLR is the requirement that every scheduled commercial bank in India is required to maintain in the form of certain liquid assets such as gold, cash and government approved securities before providing credit to the customers. The Reserve Bank of India requires statutory central auditors of banks to verify the compliance with SLR requirements of 12 odd dates in different months of a financial year not being Fridays. The objective of maintaining SLR is to have an amount in the form of liquid assets which can be used to

handle a sudden increase in demand for the amount from the depositors. The resultant report is to be sent to the top management of the bank and to the Reserve Bank.

**QUESTION:-6** Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India guidelines.

**ANSWER:-** The detailed scope of the concurrent audit should be clearly and uniformly determined for the Bank as a whole by the Bank's Central Inspection and Audit Department in consultation with the Bank's Audit Committee of the Board of Directors (ACB). In determining the scope, importance should be given to checking high-risk transactions having large financial implications as opposed to transactions involving lesser amounts. The detailed scope of the concurrent audit may be determined and approved by the ACB. Further, the guidelines issued by the RBI cover all the key areas of activities of the branch which is under concurrent audit. Most banks have prepared an Audit Manual for this purpose. Broadly stated, the following areas are covered by these guidelines:



**QUESTION:-7** In course of audit of Good Samaritan Bank as at 31st March, 23 you observed the following:

(a) In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government?

(b) The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.

**ANSWER:- (a) Government Guaranteed Advance:** If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked. Since the bank has not invoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exemption is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days. In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

**(b) The Audit Programme to Verify Advances against Life Insurance Policies is as under-**

- (i) The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer.
- (ii) The auditor should also examine whether premium has been paid on the policies and whether they are in force.
- (iii) Certificate regarding surrender value obtained from the insurer should be examined.
- (iv) (iv) The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

**QUESTION:-8** Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The bank is a consortium member of Cash Credit Facilities of ₹ 50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹ 1.75 crores towards interest the credits in X Ltd's account are to the tune of ₹ 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing. The Bank follows financial year as accounting year. Advise your views on the issue which were brought to your notice by your Audit Manager.

**ANSWER:-** The bank is a consortium member of cash credit facilities of ₹50 crores to X Ltd. Bank's own share is 10 crores only. During the last two quarters against a debit of 1.75 crores towards interest, the credits in X Ltd.'s account are to the tune of 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two

quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.

**QUESTION:- 9** You have been appointed as an auditor of LCO Bank, a nationalized bank. LCO Bank also deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over storage and issue of credit cards. How will you evaluate the Internal Control System in the area of Credit Card operations of a Bank?

**ANSWER:-** System of Internal Control in Banks: Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. Given below are examples of internal controls that are typically implemented in a bank:

Area of Focus	Examples of Internal Controls in a Bank
General	<ul style="list-style-type: none"> <li>● The staff and officers of a bank should be shifted from one position to another frequently and without prior notice.</li> <li>● The work of one person should always be checked by another person (usually by an officer) in the normal course of business.</li> <li>● The arithmetical accuracy of the books should be proved independently every day.</li> <li>● All bank forms (e.g. Cheque books, demand draft / pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer</li> </ul>

	<p>should verify the issuance and stock of such stationery.</p> <ul style="list-style-type: none"> <li>● The mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.</li> <li>● The signature book and the telegraphic code book should be kept with responsible officers and access should be allowed only to authorised officers.</li> <li>● The bank should take out insurance policies against loss due to all the risks such as fire, natural calamities, theft and employees' infidelity.</li> <li>● The financial powers of officers of different grades should be clearly defined.</li> <li>● There should be surprise inspection of head office and branches at periodic interval by the internal audit department. The irregularities pointed out in the inspection reports should be promptly rectified.</li> </ul>
Cash	<ul style="list-style-type: none"> <li>● Cash should be kept in the joint custody of two responsible officers.</li> <li>● In addition to normal checking by the chief cashier, cash should be test-checked daily and counted in full occasionally by a responsible officer other than those handling the cash. Actual cash in hand should agree with the balance shown by the Day Book every day.</li> </ul>

	<ul style="list-style-type: none"> <li>● The cashier should have no access to the customer's ledger accounts and the Day Book. This is an important safeguard as the Bank managements are often tempted to use cashiers because of their shorter working hours as ledger clerks in the absence of regular staff etc. This can result in substantial losses to the bank.</li> <li>● The counterfoil of cash receipt vouchers (e.g. counterfeits of pay-in-slips lodged by the depositors) should be signed by an officer in Cash Department, in addition to the receiving cashier.</li> <li>● Payments should be made only after the vouchers (e.g. cheques, demand drafts etc.) have been passed for payment by the authorised officer and have been entered in the customer's account.</li> <li>● Receipt and payment scrolls or their totals should be compared with the cash column of the Day-Book by independent persons.</li> <li>● High value cash receipts and payments should be verified by a higher officer/branch manager and the excess cash balance should be remitted to currency chest according to branch's retention limit on daily basis.</li> </ul>
Clearings	<ul style="list-style-type: none"> <li>● Under the Cheque Truncation System (CTS) implemented by RBI, an electronic image of the cheque is transmitted to the paying branch through the clearing house, along with relevant information like data on the MICR band, date of presentation, presenting bank, etc. This effectively</li> </ul>

	<p>eliminates the associated cost of movement of the physical cheques, reduces the time required for their collection.</p> <ul style="list-style-type: none"> <li>● As per RBI guidelines, the branch is required to either call the customer or email him for any cheque received for the amount of 5 lakh and above in respect of inward clearings.</li> <li>● The Auditor may verify the compliance on test check basis. The Auditor is to check whether signature of the drawer of the cheque is being verified by the staff or not as else there will be liability of the paying bank under all circumstances.</li> <li>● The unpaid cheques received in outward clearing should be either sent to the customers at their recorded address or the customers be informed to collect the same from bank branch.</li> </ul>
Bills for Collect on	<ul style="list-style-type: none"> <li>● All the documents accompanying the bills should be received and entered in the Register by a responsible officer. At the time of dispatch, the officer should also see that all the documents are sent along with the bills.</li> <li>● The accounts of customers or principals should be credited only after the bills have been collected or an advice to that effect received from the bank branch or agent to which they were sent for collection.</li> <li>● It should be ensured that bills sent by one branch for collection to another branch of</li> </ul>

	<p>the bank, are not taken in the bills for collect on twice in the amalgamated balance sheet of the bank. For this purpose, the receiving branch should reverse the entries regarding such bills at the end of the year for closing purposes.</p>
Bills Purchased	<ul style="list-style-type: none"> <li>● At the time of purchase of the bills, an officer should verify that all the documents of title are properly assigned to the bank.</li> <li>● Sufficient margin should be kept while purchasing or discounting a bill to cover any decline in the value of the security etc.</li> <li>● If the bank is unable to collect a bill on the due date, immediate steps should be taken to recover the amount from the drawer against the security provided.</li> <li>● All irregular outstanding account/s should be reported to the Head Office.</li> <li>● In the case of bills purchased outstanding at the close of the year the discount received thereon should be properly apportioned between the two years</li> </ul>
Loans and Advances	<ul style="list-style-type: none"> <li>● The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from the proper authorities of the bank.</li> <li>● All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be</li> </ul>

executed by the parties before advances are made.

- Sufficient margin should be kept against securities taken to cover any decline in the value thereof and to comply with Reserve Bank directives. Such margins should be determined by the proper authorities of the bank as a general policy or after detailed scrutiny for specific accounts.
- All the securities should be received and returned by responsible officer. They should be kept in the Joint custody of two such officers.
- All securities requiring registration should be registered in the name of the bank or otherwise accompanied by the documents sufficient to give title of the bank.
- All accounts should be kept within both the drawing power and the sanctioned limit as per prescribed norms. Additional temporary limit may be sanctioned, for a maximum of 20% of existing limit and 90 days maximum tenure.
- All the accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.
- The operation (in each advance account) should be reviewed at least once every year.)

Demand Drafts	<ul style="list-style-type: none"> <li>● The signatures on a demand draft should be checked by an officer with the Signature Book.</li> <li>● All the D.Ds. sold/issued by a branch should be immediately confirmed by an advice to the paying branch.</li> <li>● If the paying branch does not receive proper confirmation of any D.D. from the issuing branch or does not receive credit in its account with that branch, it should take immediate steps to ascertain the reasons.</li> </ul>
Inter Branch Accounts	<ul style="list-style-type: none"> <li>● The accounts should be adjusted only on the basis of advices (and not on the strength of entries found in the statement of account) received from other branches,</li> <li>● Prompt act on should be taken preferably by central authority, if any entries (particularly debit entries) are not responded to by any branch within a reasonable time.</li> </ul>
Credit Card Operations	<ul style="list-style-type: none"> <li>● There should be effective screening of applications with reasonably good credit assessments.</li> <li>● There should be strict control over storage and issue of cards.</li> <li>● There should be a system whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement, in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.</li> </ul>

	<ul style="list-style-type: none"> <li>● There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.</li> <li>● Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.</li> <li>● All the reimbursement (gross of commission) should be immediately charged to the customer's account.</li> <li>● There should be a system to ensure that statements are sent regularly and promptly to the customer.</li> <li>● There should be a system to monitor and follow-up customers' payments.</li> <li>● Payments overdue beyond a reasonable period should be identified and attended to carefully. For defaulting customers, credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.</li> <li>● There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.</li> </ul>
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**QUESTION:-10** You have been appointed as Concurrent Auditor of a nationalized bank branch. The main business at the branch is dealing in foreign exchange. Suggest the main areas of coverage with regard

to foreign exchange transactions of the said branch under concurrent audit.

**ANSWER:-** The areas that are typically covered as part of a concurrent audit and the suggested audit procedures are as follows:

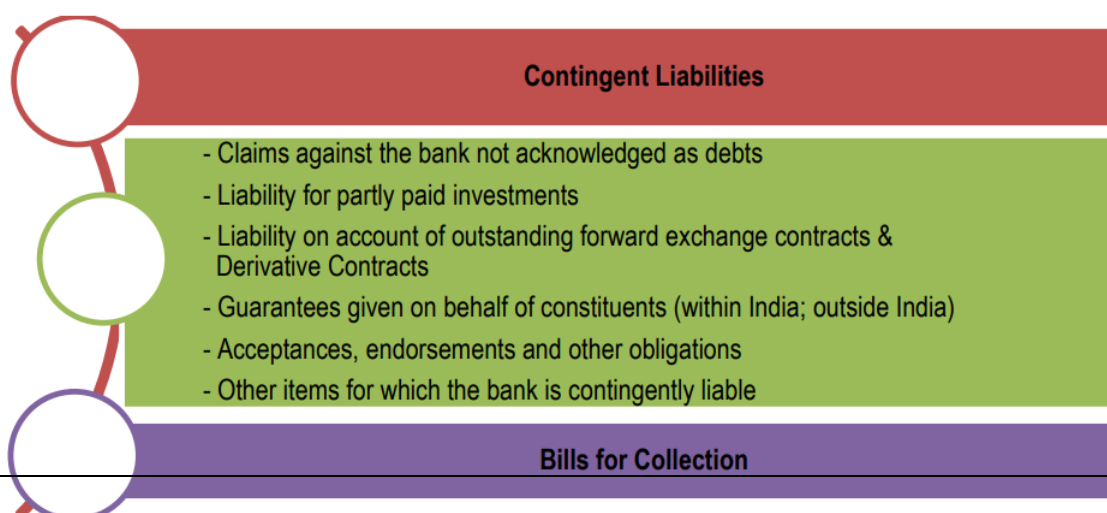
Area of Focus	Suggested Audit Procedures
Cash	<ul style="list-style-type: none"> <li>● Daily cash transactions with particular reference to any abnormal/ high value receipts and payments.</li> <li>● Proper accounting of inward and outward cash remittances.</li> <li>● Proper accounting of currency chest transactions, its prompt reporting to the RBI.</li> <li>● Expenses incurred by cash payment involving sizeable amount.</li> </ul>
Investments	<ul style="list-style-type: none"> <li>● Ensure that in respect of purchase or sale of securities the branch has acted within its delegated power having regard to its Head Office instructions.</li> <li>● Ensure that the securities held in the books of the branch are physically held by it.</li> <li>● Ensure that the branch is complying with the RBI/head Office guidelines regarding BRs, SGL forms, delivery of scrips, documentation and accounting.</li> <li>● Ensure that the sale or purchase transactions are done at rates beneficial to the bank.</li> </ul>
Deposits	<ul style="list-style-type: none"> <li>● Check the transactions about deposits received and repaid.</li> <li>● Percentage check of interest paid on deposits may be made including calculation of interest on large deposits.</li> </ul>

	<ul style="list-style-type: none"> <li>● Check new accounts opened particularly current accounts. Operations in new current/SB accounts may be verified in the initial periods to see whether there are any unusual operations.</li> </ul>
Advances	<ul style="list-style-type: none"> <li>● Ensure that loans and advances have been sanctioned properly in accordance with delegated authority.</li> <li>● Ensure that securities and documents have been received and properly charged/ registered.</li> <li>● Ensure that post disbursement supervision and follow-up is proper, such as receipt of stock statements, instalments, recovery/ renewal of sanction limits, etc.</li> <li>● Verify whether there is any misutilisation of the loans and whether there are instances indicative of diversion of funds.</li> <li>● Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions.</li> <li>● Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates.</li> <li>● Ensure proper follow-up of overdue bills of exchange.</li> <li>● Verify whether the classification of advances has been done as per RBI guidelines.</li> <li>● Verify whether the claims to DICGC and ECGC is submitted in time.</li> <li>● Verify that instances of exceeding delegated powers have been promptly reported to controlling/Head Office by the branch and have been confirmed or ratified at the required level.</li> </ul>
Foreign Exchange	<ul style="list-style-type: none"> <li>● Check foreign bills negotiated under letters of credit.</li> </ul>

	<ul style="list-style-type: none"> <li>● Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.</li> <li>● Check whether inward/outward remittance have been properly accounted for.</li> <li>● Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorised and necessary charges have been recovered.</li> <li>● Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.</li> <li>● Ensure that the overbought/oversold position maintained in different currencies is reasonable, considering the foreign exchange operations.</li> <li>● Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations</li> <li>● Ensure verification/reconciliation of Nostro and Vostro account transactions/balances.</li> </ul>
House Keeping	<ul style="list-style-type: none"> <li>● Ensure that the maintenance and balancing of accounts, ledgers and registers including clean cash is proper.</li> <li>● Early reconciliation of entries outstanding in the inter-branch and inter-bank accounts, Suspense Account, Sundry Deposits Account, DRR Account, Drafts Account, etc.</li> <li>● Ensure timely adjustment of large value entries.</li> <li>● Carry out a percentage check of calculations of interest, discount, commission and exchange.</li> <li>● Check whether debits in income account have been permitted by the competent authorities.</li> <li>● Check the transactions of staff accounts.</li> </ul>

	<ul style="list-style-type: none"> <li>● Examine the day book to verify as to how the differences in clearing have been adjusted.</li> <li>● Detect on &amp; prevent on of revenue leakages through close examination of income and expenditure accounts.</li> <li>● Verify cheques returned/bills returned register and look into reasons for return of those instruments.</li> <li>● Checking of inward and outward remittances (DDs, MTs &amp; TTs).</li> </ul>
Other items	<ul style="list-style-type: none"> <li>● In case the branch has been entrusted with government business, ensure that the transactions are done in accordance with the instructions issued by Government, RBI &amp; HQ.</li> <li>● Ensure that the branch gives proper compliance to the internal inspection/audit reports.</li> <li>● Ensure that customers' complaints are dealt with promptly.</li> <li>● Verify the statements, returns, statutory returns etc. submitted to RBI/ HQ.</li> </ul>

**QUESTION :-11** While auditing FAIR Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks. Kindly guide.



## Audit Approach

In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should obtain representation from management that:-

- (i) all off-balance sheet transactions have been accounted in the books of accounts as and when such transaction has taken place;
- (ii) all off-balance sheet transactions have been entered into after following due procedure laid down;
- (iii) all off-balance sheet transactions are supported by the underlying documents;
- (iv) all year end contingent liabilities have been disclosed;
- (v) the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/expense and which, therefore, require creation of a provision/adjustment in the financial statements;
- (vi) the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement;
- (vii) in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent

upon the invocation of the said guarantee(s) and that no violation of section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; and

(viii) such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities.

**OR**

REFER TO PARA 8 VI

**QUESTION:-12** ABC Chartered Accountants have been appointed as concurrent auditors for the branches of Effective Bank Ltd. for the year 2022-23. You are part of the audit team for Agra branch of the bank and have been instructed by your senior to verify the advances of the audit period. You are required to guide your assistant about the areas to be taken care while doing verification during the concurrent audit.

**ANSWER:-** The Third Schedule to the Act requires classification of advances made by a bank from three different angles, viz., nature of advance (like cash credit, overdrafts or term loans or bills purchased and discounted), nature and extent of security (like secured by tangible assets or covered by bank/govt guarantees), and place of making advance (i.e. Whether in India or outside India). Further, advances in India are also to be classified also on sectoral basis (like priority sector or public sector). Audit Approach: Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. The auditor is

primarily concerned with obtaining evidence about the following while carrying out audit of advances: -

- Amounts included in the balance sheet in respect of advances are outstanding at the date of balance sheet
- Advances represent amounts due to the bank
- Amounts due to the bank are appropriately supported by loan documents
- There are no unrecorded advances
- The stated basis of valuation of advances is appropriate and properly applied and recoverability of advances is recognized in their valuation.
- Advances are disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory and regulatory requirements
- Appropriate provisions towards advances are made as per RBI norms, accounting standards and generally accepted accounting practices

***It would be worth recalling that there exists elaborate and detailed control system & procedure in banks pertaining to appraisal, sanctioning, documentation, disbursement, review, monitoring and supervision of advances. Audit approach of advances should encompass designing appropriate audit procedures to obtain audit evidence in all these areas.***

**QUESTION:-13** In the course of audit of Skip Bank Ltd., you found that the Bank had sold certain of its nonperforming assets. Draft the points of audit check that are very relevant to this area of checking.

**ANSWER:-** Refer Para 7 sub heading III

**QUESTION:-14** Banks, because of certain characteristics, are distinguished from other commercial enterprises and hence it needs special audit consideration. As an auditor of a bank, specify the various peculiarities which may necessitate special audit consideration to be taken care by you?

**ANSWER:-** The banking industry is the pivot of any economy and its financial system. Banks are one of the foremost agents of financial intermediation in an economy like India and, therefore, development of a strong and resilient banking system is of utmost importance. The banking institutions in the country are working in a competitive environment and their regulatory framework is aligned with the international best practices. Thus, financial deepening has taken place in India and continues to be in progress with a focus on orderly conditions in financial markets while sustaining the growth momentum.

**Special audit considerations arise in the audit of banks because of:**

- the particular nature of risks associated with the transactions undertaken;
- the scale of banking operations and the resultant significant exposures which can arise within short period of time;
- the extensive dependence on IT to process transactions;
- the effect of the statutory and regulatory requirements;
- the continuing development of new products and services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices.

Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk.

The auditor should consider the effect of the above factors in designing his audit approach. It is imperative for Branch Auditors and SCAs (Statutory Central Auditors) to have detailed knowledge of the products offered and risks associated with them, and appropriately address them in their audit plan to the extent they give rise to the risk of material misstatements in the financial statements.

In today's environment, the banks use different applications to carry out different transactions which may include data flow from one application to other application; the auditor while designing his plans should also understand interface controls between the various applications.

**QUESTION:-15** ABC Bank had sanctioned credit limits of ₹ 100 lakh to M/s Volkart Ltd on 1st September 2021. The renewal of limits was due on 1st September 2022. While doing the statutory branch audit for the year ended 31st March 2023, you find that the renewal has not been done even though 180 days are over. The bank says that the renewal process has been initiated on time and most of the documents are received. The account is operated regularly and is in order; balance is maintained within drawing power. It also shows a letter from Volkart stating that due to a sudden death of their auditor, a new auditor had to be appointed. Procedure for appointment took some time and the new auditor was doing the audit all over again. The limit was not renewed till 31/3/2023. However, the audited financials are received on 10th April 2023 and the renewal letter was issued immediately. Your assistant is insisting that the account must be classified as NPA

since the limit was not renewed as on 31/3/2023. What is your opinion?

**ANSWER:-** As per Guidelines of Reserve Bank of India the account should be classified as NPA if renewal is not done in 180 days. However, in the present case, operations in the account are excellent. The bank has shown a letter from that company that due to certain reasons the audited financial statements are delayed. Further, the limit has been renewed before signing the audit report.

Thus, even if the sanction was issued after the balance sheet date, it relates to the position as on the balance sheet date. Therefore, it is an adjusting event under AS 4, Contingencies and Events Occurring After the Balance Sheet Date. It is also a matter of substance over form.

The auditor would consider classifying the account as a standard asset.

**QUESTION:-16** You are auditing a small bank branch with staff strength of the manager, cashier and three other staff S1, S2 and S3. Among allocation of work for other areas, S1 who is a peon also opens all the mail and forwards it to the concerned person. He does not have a signature book so as to check the signatures on important communications. S2 has possession of all bank forms (e.g. Cheque books, demand draft /pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.

**ANSWERS:-** Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. Given below are examples of internal controls that are violated in the given situation:

In the instant case, S1 who is a peon opens all the mail and forwards it to the concerned person. Further, he does not have a signature book so as to check the signatures on important communications is not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.

All bank forms (e.g. Cheque books, demand draft /pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery. In the given case, S2 has possession of all bank forms (e.g. cheque books, demand draft /pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis.

Further, content of bank that being a small branch with shortage of manpower they are not able to check the work and records on regular basis, is not tenable as such lapses in internal control pose risk of fraud.

The auditor should report the same in his report accordingly.

# HD MENTORING

## UNIT-2

**QUESTION:-1** “Fin crazy” is a P2P online platform owned by Future Technologies Pvt Limited which is registered with RBI as NBFC. Peer to Peer Platform (P2P) means an intermediary providing the services of loan facilitation via online medium or otherwise to the participants. Participants have to enter into an arrangement with NBFC-P2P to lend on its platform or avail loan facilitation services provided by it. It provides only as a medium connecting lenders and borrowers. It also carries out the credit assessment and risk profiling of the participants on the platform. It also provides services relating to loan documentation and loan recovery. The company falls outside purview of upper layer. Where does such

NBFC fit into in accordance with scale-based regulations? Suggest few audit procedures for above NBFC-P2P.

**ANSWER:-** NBFC-P2P falls in base layer in accordance with scale-based regulations of RBI. Few audit procedures for NBFC-P2P are as under: -

- Gaining an understanding of business conducted by NBFC-P2P. It should be verified that company undertakes only permissible activities applicable to such type of NBFCs like providing online marketplace to participants for lending and borrowing. It should not be engaged in business of lending funds on its own.
- Verifying certificate of registration obtained from RBI for carrying business of P2P platform.
- Verifying Board approved policy setting out eligibility criteria for participants i.e lenders and borrowers.
- Verifying board approved policy for pricing of services provided by P2P platform
- Verification of adherence to lending and borrowing guidelines prescribed by RBI
- Verifying appropriate arrangements have been entered into among participants and NBFC-P2P.
- Compliance with reporting requirements of RBI
- Verifying board approved policy for grievance redressal and complaints

**QUESTION:-2** Sugam Housing Finance Limited is in the business of housing finance activities having asset size of ₹ 800 crores. Its principal business is of providing finances for housing mainly to individuals. It is not identified by RBI in upper layer. Under scale-based regulations introduced by RBI, what should be appropriate classification for such a company? Is there any specific reporting

requirement under CARO, 2020 for statutory auditor of a company engaged in housing finance activities?

**ANSWER:-** The said company is not identified in upper layer by RBI. Under scale based regulations introduced by RBI, NBFCs undertaking housing finance activities constitute “middle layer”. The asset size is not relevant in such a case. All housing finance companies not identified in upper layer would constitute middle layer due to nature of such activities undertaken by them. There is specific reporting requirement under CARO, 2020 under clause 3 (xvi)(b) which requires auditor to report whether the company has conducted any non-Banking financial or housing finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.

**QUESTION:-3** You are auditor of a deposit taking NBFC (NBFC-D). The NBFC is identified by RBI in its upper layer and its financial statements are required to be prepared in accordance with requirements of Ind AS. The following is extract of statement of profit and loss for year ending 31st March, 2023 in accordance with Division III of Schedule III of Companies Act, 2013. Previous year figures are ignored.

**ANSWER:-** An NBFC is preparing financial statements in accordance with requirements of Division III of Schedule III of Companies Act, 2013 has to separately disclose by way of note any item of “other expenditure” exceeding 1% of total income. The said expenditure of ₹99.50 crore does not exceed 1% of total income. Hence, it meets requirements of Division III of Schedule III of Companies Act, 2013.

**QUESTION:-4** Define NBFC. Also give a brief description about types of NBFCs covering any five NBFCs.

**ANSWER:-** Refer Para 1-Definition and Types of NBFCs.

**QUESTION:-5** Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the requirements related to registration and regulation of NBFCs which an auditor needs to keep in his mind while planning the audit of NBFC which would help this firm.

**ANSWER:-** An auditor should know following points regarding registration and regulation of NBFCs: Under Section 45-IA of the RBI Act, 1934, no NBFC shall commence or carry on the business of a non-banking financial institution without obtaining a certificate of registration issued by the RBI; and having a net owned fund (NOF) of 25 lakhs (Two crore since April 1999) not exceeding two hundred lakhs rupees, as the RBI may, by notification in the Official Gazette, specify. (The RBI (Amendment) Act (1997) provided an entry point norm of 25 lakh as the minimum NOF which was revised upwards to 2 crore for new NBFCs seeking grant of certificate of registration (CoR) on or after 21 April 1999). A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45-IA of the RBI Act, 1934 can apply to the RBI in prescribed form along with necessary documents for registration. The RBI issues CoR after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied. However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock Broking Companies registered with SEBI, Insurance Company holding a valid CoR issued by IRDA, Nidhi Companies as notified under Section 406 of the Companies Act, 2013, Chit Companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank. The RBI has issued directions to NBFCs on acceptance of public deposits, prudential norms like capital

adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs. Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders

**QUESTION:-6** Satyam Pvt Ltd is a company engaged in trading activities, it also has made investments in shares of other Companies and advanced loans to group companies amounting to more than 50% of its total assets. However, trading income constitutes majority of its total income. Whether the Company is an NBFC?

**ANSWER:-** In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (net of intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by Reserve Bank of India. In the given case, though Satyam Pvt Ltd is fulfilling the criteria on the asset side, but however is not fulfilling the criteria on the income side, the company cannot be classified as a deemed NBFC.

**QUESTION:-7** Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification

procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC).

**ANSWER:- Refer Para 6**

**QUESTION:-8** You are appointed as the auditor of a NBFC registered with the RBI and which is accepting and holding public deposits. You are considering your reporting requirement in addition to your report made under Section 143 of the Companies Act, 2013 on the accounts of this NBFC as per the prescribed Directions. Please explain what points are required to be known in respect of separate report to be given by you to the Board of Directors of this NBFC.

**ANSWER:- Refer Para 7.1(3), (4)**

**QUESTION:-9** Kamna & Co LLP, a firm of Chartered Accountants, was appointed as auditor of an NBFC. The audit work has been completed. The audit team which was involved in the fieldwork came across various observations during the course of audit of this NBFC and have also limited understanding about the exceptions which are required to be reported in the audit report. They would like to understand in detail regarding the obligations on the part of an auditor in respect of exceptions in his report so that they can conclude their work. Please explain.

**ANSWER:- Refer Para 7.1(5)**

**QUESTION:-10** The Statutory Auditor of the NBFC company is required to give a report to the Board of Directors. What shall be the content of the Auditor's Report to the Board.

**ANSWER:- Refer Para 7.1**

The statutory auditor of Karma Pvt Ltd, being a Non-Deposit Taking Non-Systemically Important NBFC is required to submit separate report to the Board of Directors on the matters as specified as below:

- I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the RBI's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI.
- II. In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.
- III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

Apart from the aspects enumerated above, the auditor shall include a statement on the following matters, namely: -

- (i) Whether the Board of Directors has passed a resolution for non-acceptance of any public deposits;
- (ii) Whether the company has accepted any public deposits during the relevant period/year;
- (iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful

debts as applicable to it in terms of Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016;

Where, in the auditor's report, the statement regarding any of the items referred to matters specified above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred above, his report shall indicate such fact together with reasons thereof.

**QUESTION:-11** Krishna Pvt Ltd is primarily into the business of selling computer parts. However, the company is fulfilling the Principal Business Criteria as at the balance sheet date i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50% of Gross Income. What shall be the obligation of the Statutory Auditor in such a scenario?

**ANSWER:- Ref Para 7.1**

In the given case, Krishna Pvt Ltd is fulfilling the Principal Business Criteria i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50 % of Gross Income. The company which fulfils both these criteria shall qualify as an NBFC and hence is required to obtain Certificate of Registration (CoR) with Reserve Bank of India. In such a scenario, the statutory auditor has an obligation to submit exception report to the RBI on the following matters :

**(I)** Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 of the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016, is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:

**(a)** the provisions of Chapter III B of RBI Act (Act 2 of 1934); or

**(b)** Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Direct ons, 2016; or

**(c)** Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Direct ons, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Direct ons, 2016.

It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Direct ons, 2016.

**(II)** The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Direct ons, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

**QUESTION:-12** Mr. G. has been appointed as an auditor of LMP Ltd., a NBFC company registered with RBI. Mr. G is concerned about whether the format of financial statements prepared by LMP Ltd. is as per notification issued by the Ministry of Corporate Affairs (MCA) dated October 11, 2018. The notification prescribed the format in Division III under Schedule III of the Companies Act, 2013 applicable to NBFCs complying with Ind-AS. Mr. G wants to know the differences in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Help Mr. G.

**ANSWER:- Ref Para 8.3**

**QUESTION:-13** Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of ₹ 1,50,00,000/- (one crore fifty lakhs) and was not having registration certificate from RBI and applied for it on 30th March 2023. The company appointed Mr. Kabra as its statutory auditors for the year 2022-23. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?

**ANSWER:-** As per Clause (xvi) of Paragraph 3 of CARO 2020, the auditor is required to report that “whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.”

The auditor is required to examine whether the company is engaged in the business which attracts the requirements of the registration. The registration is required where the financing activity is a principal business of the company. The RBI restricts companies from carrying on the business of a non-banking financial institution without obtaining the registration certificate of registration. Audit Procedures and Reporting:

- (i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
- (ii) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
- (iii) Whether the company has net owned funds as required for the registration as NBFC.

(iv) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.

(v) The auditor should report incorporating the following:-

(1) Whether the registration is required under section 45-IA of the RBI Act, 1934.

(2) If so, whether it has obtained the registration.

(3) If the registration not obtained, reasons thereof.

In the instant case Abhimanyu Finance Ltd. is a Non Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of ₹ 1,50,00,000/- (one crore fifty lakhs) which is less in comparison to the prescribed limit i.e. 2 crore rupees and was also not having registration certificate from RBI (though applied for it on 30th March 2021). The auditor is required to report on the same as per Clause (xvi) of Paragraph 3 of CARO 2020.

## OVERVIEW OF AUDIT OF PUBLIC SECTOR UNDERTAKINGS

# 15

**QUESTION:-1** PGC & Associates are statutory auditors of BNPC Limited, a PSU in power sector. It is engaged in building large sized thermal power stations to accelerate development of power sector in the country. One of the financial committees of Parliament has decided to examine its physical and financial performance. It has also examined audit findings of C&AG in respect of which action is yet to be taken by the said PSU. The committee also proposes to include in its report performance of the company in various operational matters. Which financial committee of Parliament deals with such matters? Outline its main functions.

**ANSWER:-** The said matters are dealt by Committee on Public Undertakings (COPU). The functions of the Committee are –

- (i) to examine the reports and accounts of public undertakings.
- (ii) to examine the reports of the C&AG on public undertakings.
- (iii) to examine the autonomy and efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
- (iv) to exercise such other functions vested in the PAC and the Estimates Committee as are not covered above and as may be allotted by the Speaker from time to time.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including

evaluation of the policies, programmes and financial working of the undertaking

**QUESTION:-** PS & Associates are statutory auditors of a Central government owned company for a particular year. The statutory auditors were required to examine the following areas mandatorily, provide their specific replies and also their impact on financial statements for that particular year in their audit report.

1. Whether the company has system in place to process all the accounting transactions through IT system? If yes, the implications of processing of accounting transactions outside IT system on the integrity of the accounts along with the financial implications, if any, may be stated.

2. Whether there is any restructuring of an existing loan or cases of waiver / write off of debts / loans/ interest etc. made by a lender to the company due to the company's inability to repay the loan? If yes, the financial impact may be stated. Whether such cases are properly accounted for? 3. Whether funds (grants/subsidy etc.) received / receivable for specific schemes from Central government or its agencies were properly accounted for / utilized as per its term and conditions? List the cases of deviation.

Can you gauge likely nature of such responsibility thrust upon auditors of above PSU?

**ANSWER:-** The above areas for which statutory auditors of PSU were required to examine, report and indicate impact of these matters in financial statements are likely to relate to directions issued by C&AG to statutory auditors under section 143(5) of Companies Act, 2013.

In terms of section 143(5), in case of a government company, the C&AG has the power to direct the auditor the manners in which

accounts of company are required to be audited and auditor shall submit audit report which among other things, include the direct orders, if any, issued by the C&AG the act on taken thereon and its impact on the accounts and financial statements of the company.

**QUESTION:-3** The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG.

**ANSWER:- Refer Para 9.**

**QUESTION:-4** ABG & Co., a Chartered Accountant firm has been appointed by C & AG for performance audit of a Sugar Industry. What factors should be considered by ABG & Co., while planning a performance audit of Sugar Industry?

**ANSWER:- FACTORS TO BE CONSIDERED WHILE PLANNING THE PERFORMANCE Refer Para 6.2**

**QUESTION:-5** Sunlight Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Goa with a new technology for a cost of ₹ 5,750 crore. The project had seen delay in commencement and cost overrun. State the matters that a Comprehensive Audit by C&AG may cover in reporting on the performance and efficiency of this project.

**ANSWER:- Refer Para 7**

**QUESTION:-6** “A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.” Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

**ANSWER:- Refer Para 6.**

**QUESTION:-7** BT Ltd, a company wholly owned by central government was disinvested during the previous year, resulting in 40% of the shares being held by public. The shares were also listed on the BSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the BSE etc. Sam, the FM of the company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

**ANSWER:-** Section 2(45) of the Companies Act, 2013, defines a “Government Company” as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions

on the manner in which the audit should be conducted by them. The listing of company's shares on a stock exchange is irrelevant for this purpose and hence Sam's opinion is not correct.

**QUESTION:-8** You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task?

**ANSWER:- Refer Para 6.2**

**QUESTION:-9** Comptroller & Auditor General appointed Verma & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG.

**Answer:-** In the given scenario, C&AG appointed Verma & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit. A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting

performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG. Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities. Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action. Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

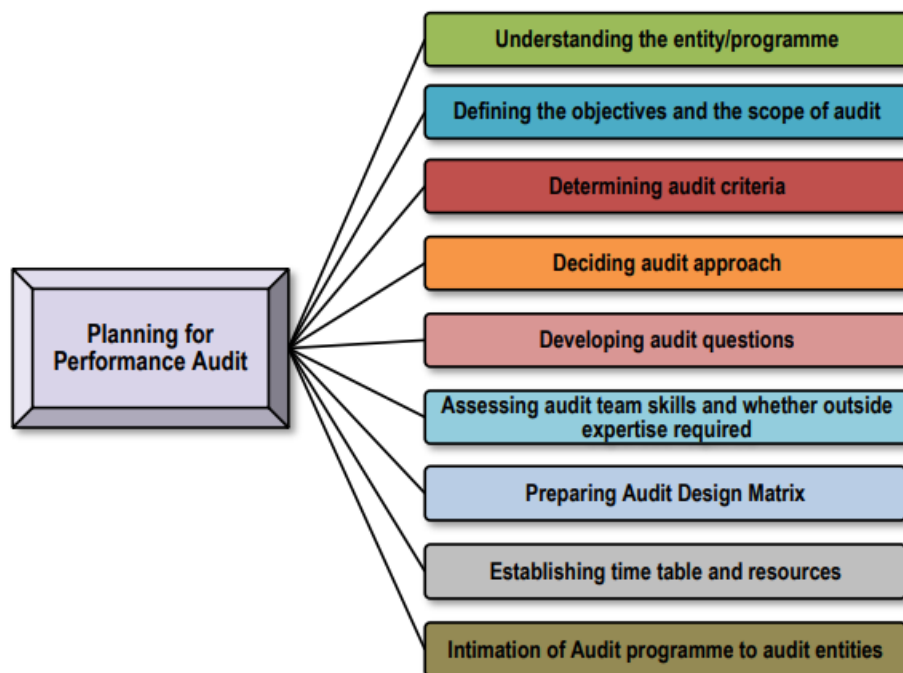
Thus, rejection of audit report (submitted by auditor) by C&AG is in order as audit with a view to merely check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by auditor is not performance audit in all aspects.

**QUESTION:-10** The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:

- (i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;
- (ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;
- (iii) metering, billing and collection was managed efficiently and effectively;
- (iv) monitoring and internal controls were efficient.

What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

**ANSWER:-** In the given scenario, in view of the objectives discussed, performance audit is being referred. R



**INTERNAL AUDIT****16**

**QUESTION:-1** After an illustrious career in Indian Audit & Accounts Service for about 25 years, Parteek, a post graduate in law, has taken voluntary retirement from government service. Being in fine spirits, he wants to take responsibilities in corporate sector as Chief internal auditor. On looking at attractive compensation packages, he applied for such position in a leading listed company engaged in oil refining business. The Board of company is keen on him due to his impressive credentials. Can he be appointed in this leading position of said company?

**ANSWER:-** As per section 138 of Companies Act, 2013 the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company. The Board can appoint any professional as may be decided by it. The applicant in question is a law post graduate and he has spent 25 years of his career in Indian Audit & Accounts Service. Therefore, he has got the necessary experience and skills required for the said vacancy. The Board would be in a position to appoint such a competent and experienced person in the field of auditing as its Chief Internal auditor.

**QUESTION:-2** CA Deva is internal auditor of a listed company. The company wants to make sure that it is in compliance with SEBI requirements at all times and it is never on the wrong side of law. It asks its internal auditor to manage its compliance tracking system including directly corresponding with regulator in this regard. The

profile and scope of internal audit agreed at the time of appointment included “compliance with laws and regulations.”

Can he perform such type of activities in capacity of internal auditor of company?

**ANSWER:-** The Internal Auditor does not assume any responsibility to manage or operate the compliance framework or to take compliance related decisions. It is not responsibility of the Internal Auditor to execute or resolve compliance related risks (e.g., engaging directly with regulators, etc.). Although internal audit function provides independent assurance to enhance governance (which includes compliance with laws and regulations), it does not assume operational responsibility of its compliance framework. It is the responsibility of the management. He is responsible for auditing the compliance framework and not managing it. Similarly, he does not accept compliance related risks like directly engaging with regulator.

**QUESTION:-3** Up Down Limited is in doldrums since last two years. The demand for its products has declined drastically. The statutory auditor is of the view that situation has put into question going concern assumption of the company. Its internal auditor has helped management in devising a strategy to deal with such risks and come out of the situation. The plan includes venturing into different product lines using same plant with minor modifications. Further, internal auditor has also prepared estimates of revenue generation along with cash flows.

Can statutory auditor place total reliance on work performed by internal auditor in this regard?

**ANSWER:-** The greater the judgment needed to be exercised in planning and performing the audit procedures and evaluating the audit evidence, the external auditor will need to perform more

procedures directly because using the work of the internal audit function alone will not provide the external auditor with sufficient appropriate audit evidence. The appropriate use of going concern assumption requires significant judgment on part of statutory auditor. Therefore, statutory auditor cannot place total reliance on internal auditor's work in this regard and he should perform more procedures directly.

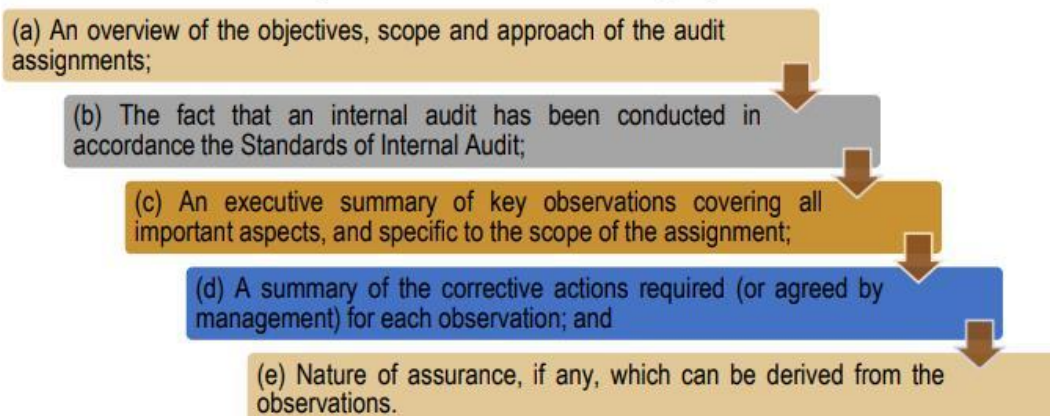
**QUESTION:-4** Write a short note on Internal Audit Report.

**ANSWER:-** The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action. However, in case the internal auditor comes across any actual or suspected fraud or any other misappropriation of assets, it would be more appropriate for him to bring the same immediately to the attention of the management. **As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:**

At the end of a particular audit assignment, an "Internal Audit Report" covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.

On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

This Standard on Internal Audit (SIA) deals with the internal auditor's responsibility to issue only the first type of reports, the Internal Audit Report pertaining to specific audit assignments and not to the periodic (e.g. Quarterly) reporting for the whole entity as per the Annual/Quarterly audit plan. On the basis of the internal audit work completed, the Internal Auditor shall issue a clear, well documented Internal Audit Report which includes the following key elements:



The content and form of the Internal Audit Report are to be established by the Internal Auditor based on his best professional judgement, in consultation with the auditee and, if necessary, with inputs from other key stakeholders. No internal audit report shall be

issued in final form unless a written draft of the report has previously been shared with the auditee.

**OR**

Refer To Para 6

**QUESTION:-5** State the important aspects to be considered by the External auditor in the evaluation of the Internal Audit Function.

**Answer:- Evaluation of Internal Audit Functions by External Auditor:**

The external auditor's general evaluation of the internal audit function will assist him in determining the extent to which he can place reliance upon the work of the internal auditor. The external auditor should document his evaluation and conclusions in this respect. The important aspects to be considered in this context are:

**(a) Organisational Status** - Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself, the internal auditor reports to the management. In an ideal situation, his reports to the highest level of management and are free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.

**(b) Scope of Function** - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate, acts upon internal audit recommendations.

**(c) Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.

**(d) Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.

**QUESTION:-6** AB Pvt. Ltd. company has outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint an internal auditor. Please guide him for the applicability of the same and who can be appointed as an internal auditor and what work would be reviewed by him.

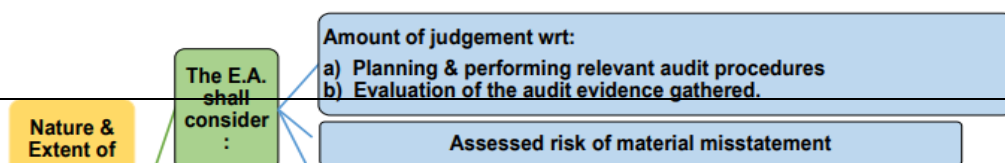
**ANSWER:- Applicability of Internal Audit:** Sect on 138 of the Companies Act, 2013 states that every private limited company is required to conduct internal audit if its outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year. In view of above provisions, AB Pvt. Ltd. is under compulsion to conduct internal audit as its loans or borrowings are falling under the prescribed limit.

**Who can be appointed as Internal Auditor-** The internal auditor shall either be a chartered accountant or a cost accountant, whether engaged in practice or not, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.

The internal auditor may or may not be an employee of the company.

**Work to be reviewed by Internal Auditor-** Refer Para 2.

**QUESTION:-7** Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State



the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.

**ANSWER:-**

The external auditor shall evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with the planned use of the work of the internal audit function, would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. **OR REFERTO PARA 7.3**

**QUESTION:-8** Mr. A is appointed as a statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

**(a)** Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.

**(b)** Will your answer be different if Mr. A asks direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

**ANSWER:- (a) Direct Assistance from Internal Auditor:** As per SA 610 “Using the Work of Internal Auditor”, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit. Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement. Significant judgments include the following:

- Assessing the risks of material misstatement;
- Evaluating the sufficiency of tests performed;
- Evaluating the appropriateness of management’s use of the going concern assumption;
- Evaluating significant accounting estimates; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor’s report.

In view of above, Mr. A cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

**(b) Direct Assistance from Internal Auditor in case of External Confirmation Procedures:** SA 610 “Using the Work of Internal Auditor”, provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned. Further, in accordance with SA 505, “External Confirmation” the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal

auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

**QUESTION:-9** The XYZ Ltd has to appoint Mr. A as Chief Internal Auditor to lead the internal audit function for the Company. The Managing Director of the Company has asked the HR head to define the reporting structure of the Chief Internal Auditor, so that he can discharge his duties objectively? Suggest the ideal reporting structure of the Chief Internal Auditor that HR head may propose to the Managing Director?

**ANSWER:-** HR Head need to evaluate multiple options and identify most suitable option in light of the relevant provisions, guidance and overall governance of the organization. HR head also need to evaluate different options for his administrative reporting and various options for functional reporting of Chief Internal Auditor. The possible options to be considered and evaluated include Board of Directors, Audit Committee, Managing Director of the Company, Chief Executive Officer or Chief Financial Officer.

As per section 138 of the Companies Act 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

As per the revised definition of the term 'Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, "Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives".

**Refer para 3.1,** The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This

independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

As per the requirement of the above stated provision, Chief Internal Auditor need to be independent of the operational activities and report of Audit Committee / Board of Directors to enjoy his true status of independent auditor. He may administratively report to CEO or Managing Director for his administrative reporting purpose or any other similar authority till the time it is approved by Board of Directors and it does not impact his independence to be able to perform his duties and report to audit committee / Board of Director independently.

**QUESTION:-10** The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their Internal Audit plan for next financial year? What approach would Mr. A follow to prepare the internal audit plan for next year?

**ANSWER:- Refer para 2.0.**

The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner. Internal audit plan should be developed in such a manner that all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle. Also, ensuring that appropriate consideration is made and adequate balance is ensured to the following:

- Risk underlying the business process

- Value that the internal audit can provide to the organization
- Effort involved in conducting the internal audit for a particular business process
- Risk Appetite of the organization
- Coverage of all auditable areas within the defined time range

**QUESTION:-11** The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. to perform detailed analysis of their expenses in previous year and report all risks and underlying gaps? What audit approach should Internal Auditor follow to identify such gaps?

**ANSWER:- Refer para 5.0**

**QUESTION:-12** The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. to present detailed report on their finding and areas where immediate action is needed to mitigate critical risks? What should be the content of internal audit report to address this requirement of the Audit Committee?

**ANSWER:- Refer para 6.0**

As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

- At the end of a particular audit assignment, an “Internal Audit Report” covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of

the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.

➤ On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee. Accordingly, a typical internal audit report should include the following:

- Audit Scope performed;
- Audit period Covered;
- Executive Summary;
- Summary of the critical findings;
- Detailed audit findings with elaboration on business impact and root cause of such issues;
- Rating of the highlighted issues (E.g High / Medium / Low) in accordance to the rating criteria approved by Audit Committee;
- Audit recommendation to improve control environment and address the highlighted finding;
- Response received from the responsible functional authority containing action plan and target timelines for action.

**QUESTION:-13** The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their analysis on the implementation of recommendation of previous audit report and highlight critical areas which need immediate attention of Audit Committee? What should be the steps followed by internal auditor to address this requirement of Audit Committee?

**ANSWER:- Refer para 6.1**

As per SIA 390 Monitoring and Reporting of Prior Audit Issues, the Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance. The responsibility to implement the action plans remains with the management. In monitoring and reporting of prior audit issues, the responsibility of the Internal Auditor is usually in the form of an "Act on Taken Report (ATR) of previous audits". To address the requirement of Audit Committee in the given situation, Internal Auditor should assess the action taken against the previous audit findings and report a summary of the action taken by the management. Typical Act on Taken Report may include the following:

- Reference to the previous audit reporting containing the reported issues
- Implementation Action agreed by the management along with target implementation date
- Status of action taken by management. The same may be classified under Implemented / Not Implemented
- Residual risk and rating for any unimplemented action

- Audit findings not implemented for long period of time
- Any critical audit finding that require immediate action for action or implementation

# HD MENTORING

## DUE DILIGENCE, INVESTIGATION & FORENSIC ACCOUNTING

# 17

**QUESTION:-**1 CA. Y is employed with a leading private sector BDFP Bank posted in NOIDA branch. One of the existing borrowers has approached branch with a proposal to sanction fresh term loan of `5 crore with commensurate increase in working capital credit facilities relating to expansion of its garment manufacturing unit. While performing due diligence, he notices that company was formed just two years ago and had availed term loan of `10 crore and cash credit facilities of `5 crore respectively. Its sales have increased from `25 crores in first year to `45 crores in year just ended. It is generating cash profits and is timely servicing its debts. The borrower was earlier catering to domestic market. However, now it is in process of procuring export orders and working assiduously in this regard. The expansion plans are in line with development in area of marketing relating to exports. However, there are a large number of units catering to domestic and export market of garments in NOIDA, Delhi and surrounding areas. There is also demand slump in biggest US market. Besides, the unit is family-based and relies upon marketing skills of its main promoter. There is lack of well-paid qualified staff with the borrower to deal effectively with its customers both domestic as well as foreign. He starts jotting down and elaborating above points. Identify what he is trying to do as part of due diligence

**ANSWER:-** As part of due diligence exercise, he is performing SWOT analysis of borrower. He is making analysis of strengths, weaknesses, opportunities and threats (SWOT) pertaining to borrower. Features such as rise in sales, generation of cash profits and timely service of debts represent borrower strengths. Lack of well-paid qualified staff to deal effectively with its domestic and foreign customers is an area

of weakness. Entering into export market presents opportunity for borrower and presence of large number of competitors and demand slump in US market reflect threats.

**QUESTION:-2** A company has installed an Effluent treatment plant (ETP) in compliance with pollution control regulations of the state government. The authority structure in the company is fairly decentralized and top management of the company has given considerable leeway to different departments for meeting their manpower requirements in accordance with emerging and changing needs from time to time. Of late, the top management has grown suspicious over manpower expenditure in section maintaining and beautifying area around ETP. There is a system in the company where time cards are punched by all employees to mark attendance. Suggest any one procedure you would perform as an investor to bring out the facts.

**ANSWER:-**THE attendance record of employees pertaining to that section can be analysed with regards to in and out time. Further, surprise visit to the site can be conducted to see the actual number of workers at a point of time. It may reveal ghost workers. Discrepancies in attendance records vis-à-vis actual number of workers present could reveal dummy workers. Such a visit would also give indication of actual work done in the area and give an inkling of productivity of employees.

**QUESTION:-3** X Limited engaged in manufacturing of floor coverings has taken a Product Liability Insurance policy (PLI). Such a policy covers risk of liabilities for damages for bodily injury resulting from sale and distribution of floor coverings by vendors of X Limited's products. The policy is also subject to "claim series" clause. A Claims

Series event is a series of two or more claims arising from one specific common cause which are attributable to the same fault in design or manufacture of products or to the supply of the same products showing the same defect. A claim series event is deemed to be one claim under the terms & conditions of PLI policy. The company has been asked to shell out damages of `5 crore due to supply of faulty products to one of its vendors. The vendor had sold floor coverings to a 5-star hotel which has alleged that harmful chemicals used in dyeing of floor coverings have resulted in skin ailments to some of its guests. Being in capacity of Forensic Professional appointed by insurance company, what special issues you would keep in mind while dealing with claims involving PLI policy covering such matters?

**ANSWER:- (i)** In claims involving product liability insurance policies, many documents are required from third parties. The third party may be unwilling to provide relevant documents to Forensic Professional concerning the very organization responsible for causing damages.

(ii) Independence of Forensic Professional become paramount in such types of assignments because it involves engagement with parties who are not directly claiming from insurance company. Forensic Professional needs to resist any pressure or interference in establishing the scope of the assignments or the manner in which the work is conducted and reported.

(iii) The company might be willing to negotiate it to salvage its reputation. It can lead to additional complexities.

(iv) Quantification of legal liability under the policy can prove to be a challenging task and it has to be determined in accordance with policy terms & conditions.

(v) Careful analysis of date of loss when first claim occurred in accordance with “claim series” clause and whether the same falls under the policy

**QUESTION:-4** Sri Rajan is above 80 years old and wishes to sell his proprietary business of manufacture of specialty chemicals. Ceta Ltd. wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business. What procedures you would adopt before you could render any advice to Ceta Ltd.?

**Answer:- Refer Financial Due Diligence given in Para 3.**

**QUESTION:-5** An American Company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of more than 65% of the industrial gas business in India. It requests you to conduct a “Due Diligence” of this Indian Company and submit your Report. List out the contents of your Due Diligence Review Report that you will submit to your USA based Client.

**Answer:- Refer Para 6.**

**Quest on :-6** KDK Bank Ltd., received an application from a pharmaceutical company for takeover of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. KDK Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.

**Answer:- Refer Over-Valued Assets Part given in Para 3.**

**Quest on :-7** “Due diligence is different from audit” – Explain the difference between due diligence and audit.

**ANSWER:- Refer Para 1.**

**Quest on :-8** PB Ltd. entered into a deal with SV Ltd. for buying its business of manufacturing wooden products/ goods. PB Ltd. has appointed your firm for conducting due diligence review and they want to know the cash generating abilities of SV Ltd. What points will you check in order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally?

**ANSWER:-** In order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally, one is required to verify: (a) Is the company able to honor its commitments to its trade payables, to the banks, to the government and other stakeholders? (b) How well is the company able to convert its trade receivables and inventories? (c) How well the Company deploys its funds? (d) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds? (e) What is the investment pattern of the company and are they easily realizable?

**Refer Cash Flow in Para 3.**

**Quest on :-9** CA. Sanjana is acting as Credit manager in branch of DFC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth `10 crore for meeting usual business requirements. It is a prospective new client. She checks past history of the company, background of promoters & directors, shareholding pattern and nature of business. Assessment of financial results of past years and future projections is also undertaken. She also carries out SWOT analysis of the company. Besides, assessment of net worth of directors is also undertaken. Status of CIBIL score and position of name of promoters/directors in RBI defaulter list is also verified. She

also makes discreet inquiries from few clients of the branch engaged in similar line of activity regarding credit worthiness of company, its promoters and directors. Based on above-

(a) Identify activity being performed by CA Sanjana and discuss its nature.

(b) Would your answer be different if this activity was to be performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.

(c) Name any three other areas where identified activity can be undertaken.

**ANSWER:-** (a) The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction.

Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans. Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the

target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

(b) There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.

(c) The areas where due diligence may be undertaken are: -

(i) Corporate restructuring

(ii) Venture capital financing

(iii) Public offerings

**Question :-10** A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not. List out the points you will cover in your investigation before submitting your report to the General Manager.

**ANSWER:- Refer Para 11.3.**

**Question :-11** What are the important steps involved while conducting investigation on behalf of an Incoming Partner?

**ANSWER:- Refer Para 11.1.**

**Quest on :-12** Mr. Clean who proposes to buy the proprietary business of Mr. Perfect, engages you as investment accountant. Specify the areas which you will cover in your investment.

**ANSWER:- Refer Para 10 & 11.5**

**Quest on :-13** In a Company, it is suspected that there has been embezzlement in cash receipts. As an investor, what are the areas that you would verify?

**ANSWER:- Refer Cash Receipts embezzlement in Para 11.4.1**

**Quest on :-14** J Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd., what factors would you consider in assessing the future maintainable turnover?

**ANSWER:-** In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

- (i) **Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
- (ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- (iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
- (iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products

which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

**Question :-15** MF. Ltd., engaged in the manufacturing of various products in its factory, is concerned with shortage in production and there arose suspicion of inventory fraud. You are appointed by MF Ltd. To evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory?

**ANSWER:- Refer Inventory Fraud in Para 11.4.1**

**Question :-16** In a Public Limited Company, it is suspected by the Management that there has been embezzlement in supplier's ledger. As an auditor of the Company, you have been asked to investigate the matter. What are the major areas that you would verify in this regard

**ANSWER:- Refer Areas to be verified in case of embezzlement in supplier's ledger in Para 11.4.1.**

**Question :-17** General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose. In view of the above, you are required to brief out the difference between Audit and Investigation.

**ANSWER:- Refer Para 7.1.**

**Question :-18** Enumerate the steps to be undertaken in case of forensic accounting process.

**ANSWER:- Refer Para 14.**

**Quest on :-19** Briefly discuss the key content of Forensic Accounting and Investment Report.

**ANSWER:- Refer Para 15.**

**Quest on :-20** ABC Ltd. is a listed company having turnover of ₹ 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of ₹ 20 crore.

Rupees (In crore)	Purpose
10.0	for Building
8.5	- for Machinery
1.5	- for Working Capital
20 Crore	Total

Project gets implemented in 2022-23 and one of the accountants report to the Managing Director that some suspicious transactions are noticed in the purchase of building material. But the Management is confused as to whether they should get an audit or Forensic Accounting done for the same. Advise Management about the difference in forensic accounting and audit.

**ANSWER:- Refer Para 12.**

## SUSTAINABLE DEVELOPMENT GOALS (SDG) & ENVIRONMENT, SOCIAL AND GOVERNANCE (ESG) ASSURANCE

# 18

**QUESTION:-1** You have recently joined a listed company after qualifying CA final exams through campus placement programme conducted by CMI&B at ICAI. Although the company you have joined in is not amongst top 1000 listed companies in the country, it wants to include "Sustainability reporting" in accordance with Global Reporting Initiative framework (GRI) in its annual report on voluntary basis. "Sustainability reporting" seems to be new buzzword in corporate circles and you are assigned responsibility for collating all the information required for such reporting. In above context, dwell upon what is your understanding of "Sustainability reporting"? Can you list some of its expected benefits?

**ANSWER:-** Sustainability reporting is an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development. Sustainability reporting refers to the information that companies provide about their performance to the outside world on a regular basis in a structured way. It is the comprehensive mechanism of measuring and disclosing sustainability data with performance indicators and management disclosures.

**Expected Benefits:** It can help stakeholders to understand organization's performance vis a vis sustainability and impacts. The reporting process emphasizes the link between financial and non-financial performance. Such reporting can help entities to focus on long-term value creation, by addressing environmental, social and governance (ESG) issues. Since investors are increasingly recognising

that environmental and social issues provide both risks and opportunities in respect of their investments and are seeking disclosures on environmental and social performance of businesses, they can use ESG performance of companies to make investment decisions. Investing in social and environmental issues will not only improve own business continuity of companies but also put them in a better position with their B2B (Business to Business) customers as well as enable them to acquire new ones.

**QUESTION:-2** Trustworthy Industries Limited (a listed company) has already been preparing and disclosing its sustainability report based upon internationally accepted reporting framework of “Integrated Reporting” on a voluntary basis even some years before BRSR reporting became mandatory. Even after BRSR reporting became mandatory, it is cross-referencing disclosures made under such reporting to disclosures sought under BRSR. The key thrust of “Integrated Reporting” is how company creates value over short, medium and long term. Following further information is provided in respect of the above company: - [i] It has increased the number of customers using digital customer mobile app of the company from 2 lac users to 4 lac users. There is 100% increase in digital collection. It has benefited customers of the company and resulted in use of digital methods for business operations of the company. [ii] It has increased the number of beneficiaries under its flagship CSR programmes from previous 10000 to 75000. It has provided value for communities and provided sustainable livelihood to them. Discussing above information, identify which of the capitals of “Integrated Reporting” are being referred to at [i] and [ii] respectively?

**ANSWER:-** The information at [i] states that company has increased the number of customers using digital mobile app. Besides, it has led to 100% increase in digital collection. Therefore, it involves use of technology for deriving business benefits. It has invested in innovation

deriving business benefits from digitization. The capital referred to at [i] is “Intellectual Capital”. Increase in number of beneficiaries under flagship CSR programmes providing value for communities and sustainable livelihood is an example of relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being. The capital referred to at [ii] is “Social and Relationship Capital.”

**QUESTION:-3** What type of companies are required to mandatorily furnish the Business Responsibility and Sustainability Report (BRSR) as per the SEBI circular with effect from FY 2022-23?

**ANSWER:- Refer para 7.1 3. Refer para 3. 4.**

**QUESTION:-4** What are the nine principles of BRSR? How are the nine principles of BRSR linked with the 17 UN Sustainable Development Goals?

**ANSWER:- 2. Refer para 7.1.1**

**QUESTION:-5** What are the global trends in sustainable reporting?

**ANSWER:- Refer para 3.**

**QUESTION:-6** What are the 6 C’s of Integrated reporting?

**ANSWER:- . Refer para 4.**

**QUESTION:- 7** What is the methodology of providing assurance in BRSR?

**ANSWER:- Refer para 7.1.4**

**QUESTION:-8** What is the auditor’s role on ESG aspects in an audit of financial statements of the Company?

**ANSWER:- Refer para 8**

## PROFESSIONAL ETHICS & LIABILITIES OF AUDITORS

19

**QUESTION:-1** P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2023, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Is P guilty of professional misconduct?

**ANSWER:-** Advising on Portfolio Management Services: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients.

**QUESTION:- 2.** Mr. G, a Chartered Accountant in practice as a sole proprietor has an office in Mumbai near Church Gate. Due to increase in professional work, he opens another office in a suburb of Mumbai which is approximately 80 kilometers away from the municipal limits of the city. For running the new office, he employs

three retired Income-tax Officers. Is Mr. G guilty of professional misconduct?

**ANSWER:-** In terms of section 27 of the Chartered Accountants Act, 1949, if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. There is however an exemption for the above if the second office is located in the same premises, in which the first office is located; or the second office is located in the same city, in which the first office is located; or the second office is located within a distance of 50 kms from the municipal limits of a city, in which the first office is located. Since the second office is situated beyond 50 kms of municipal limits of Mumbai city, he would be liable for committing a professional misconduct.

**QUESTION:- 3.** Write a short note on Other Misconduct.

**ANSWER:- Refer Para 7.2**

**QUESTION:-4.** Mr. K, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. Discuss this in the light of Professional Ethics issued by ICAI.

**ANSWER:-** Sharing of Audit Fees with Non-Member: As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant in practice pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative

of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India. In the instant case, Mr. K, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. In this case, it is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into. The Chartered Accountant had shared his profits and, therefore, Mr. K will be held guilty of professional misconduct under the Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949.

**QUESTION:-5.** Mr. X who passed his CA examination of ICAI on 18th July, 2022 and started his practice from August 15, 2022. On 16th August 2022, one female candidate approached him for articled clerkship. In addition to monthly stipend, Mr. X also offered her 1% profits of his CA firm. She agreed to take both 1% profits of the CA firm and stipend as per the rate prescribed by the ICAI. The Institute of Chartered Accountants of India sent a letter to Mr. X objecting the payment of 1% profits. Mr. X replies to the ICAI stating that he is paying 1% profits of his firm over and above the stipend to help the articled clerk as the financial position of the articled clerk is very weak. Is Mr. X liable to professional misconduct?

**ANSWER:- Sharing Fees with an Articled Clerk:** As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other

than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India. In view of the above, the objections of the Institute of Chartered Accountants of India, as given in the case, are correct and reply of Mr. X, stating that he is paying 1% profits of his firm over and above the stipend to help the articled clerk as the position of the articled clerk is weak is not tenable. Hence, Mr. X is guilty of professional misconduct in terms of Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949.

**QUESTION:-** 6. M/s XYZ, a firm in practice, develops a website “xyz.com”. The colour chosen for the website was a very bright green and the web-site was to run on a “push” technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator. Is this website in compliance with guidelines issued by ICAI in this regard?

**ANSWER:-** Posting of Particulars on Website: The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s XYZ are:

- ◆ No restriction on the colours used in the website;
- ◆ The websites are run on a “pull” technology and not a “push” technology;

◆ Names of clients and fees charged not to be given. However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that “This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator]. In view of the above, M/s XYZ would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

**QUESTION:-7.** A partner of a firm of chartered accountants during a T.V. interview handed over a bio-data of his firm to the chairperson. Such bio-data detailed the standing of the international firm with which the firm was associated. It also detailed the achievements of the concerned partner and his recognition as an expert in the field of taxation in the country. The chairperson read out the said bio-data during the interview. Discuss whether this act on by the Chartered Accountant would amount to misconduct or not.

**ANSWER:-** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means since it shall constitute professional misconduct. The bio-data was handed over to the chairperson during the T.V. interview by the Chartered

Accountant which included details about the firm and the achievements of the partner as an expert in the field of taxation. The chairperson simply read out the same in detail about association with the international firm as also the achievements of the partner and his recognition as an expert in the field of taxation. Such an act would definitely lead to the promotion of the firms' name and publicity thereof as well as of the partner and as such the handing over of bio-data cannot be approved. The partner would be held guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

**QUESTION:-8.** (a) An advertisement was published in a Newspaper containing the photograph of Mr. X, a member of the institute wherein he was congratulated on the occasion of the opening ceremony of his office. (b) Mr. X, a Chartered Accountant and the proprietor of X & Co., wrote several letters to the Assistant Registrar of Co-operative Societies stating that though his firm was on the panel of auditors, no audit work was allotted to the firm and further requested him to look into the matter.

**ANSWER:-** (a) Publishing an Advertisement Containing Photograph: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. In the given case, Mr. X published an advertisement in a Newspaper containing his photograph on the occasion of the opening ceremony of his office. On this context, it may be noted that the advertisement which had been put in by the member is quite prominent. If soliciting of work is allowed, the independence and forthrightness of a Chartered Accountant in the discharge of duties

cannot be maintained. The above therefore amounts to soliciting professional work by advertisement directly or indirectly. Mr. X would be therefore held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. (b) Soliciting Professional Work: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. In the given case, Mr. X, a Chartered Accountant and proprietor of M/s X and Co., wrote several letters to the Assistant Registrar of Co-operative Societies, requesting for allotment of audit work. In similar cases, it was held that the Chartered Accountant would be guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The writing of continuous letter to ascertain the reasons for not getting the work is quite alright but in case such either amount to request for allowing the work then Mr. X will be liable for professional misconduct.

Consequently, Mr. X would therefore be held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949

**QUESTION:-9.** A practicing Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant. Is this a misconduct?

**ANSWER:-** Cost Accountant: As stated in the Illustration given in clause 7 with reference to tax consultant, this would also constitute misconduct under section 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. A chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in

practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". However as per the Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant"

**QUESTION:-10.** Mr. Nigal, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While delivering the speech, he told to the audience that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment.

**ANSWER:-** Using Designation Other Than a CA and Providing Details of Services Offered: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients. Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered

accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council. Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write must not be promotional of his or his firm but must be an objective professional view of the topic under consideration. Thus, it is improper to use designation "Management Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Management Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6)

**QUESTION:-11.** Mr. A is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. Y a Chartered Accountant his employee for taking care of routine matters of his office. During his

absence Mr. Y has conducted the under mentioned jobs in the name of M/s A & Co. (i) He issued the audit queries to client which were raised during the course of audit. (ii) He issued product on certificate to a client under the GST Act. (iii) He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities. Please comment on eligibility of Mr. Y for conducting such jobs in name of M/s A & Co. and liability of Mr. A under the Chartered Accountants Act, 1949.

**ANSWER:-** Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements". In this case CA A proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc. (i) In the given case, Mr. Y, a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here Y is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act. (ii) Further, issuance of product on certificate to a client under GST Act

by Mr. Y being an employee of M/s A & Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA A is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949. (iii) In this instance, Mr. Y, CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax

Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matters in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

**QUESTION:-12.** XYZ Co. Ltd. has applied to a bank for loan facilities. The bank on studying the financial statements of the company notices that you are the auditor and requests you to call at the bank for a discussion. In the course of discussions, the bank asks for your opinion regarding the company and also asks for detailed information regarding a few items in the financial statements. The information is available in your working paper file. What should be your response and why?

**ANSWER:-** As per Clause (1) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force. SA 200 on "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information

acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose". In the instant case, the bank has asked the auditor for detailed information regarding few items in the financial statements available in his working papers. Having regard to the position stated earlier, the auditor cannot disclose the information in his possession without specific permission of the client. As far as working papers are concerned, working papers are the property of the auditor. The auditor may at his discretion, make portions of or extracts from his working papers available to his client". Thus, there is no requirement compelling the auditor to divulge information obtained in the course of audit and included in the working papers to any outside agency except as and when required by any law.

**QUESTION:-13.** Mr. A, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. X gave him an idea to start online services and give stock certificates to traders with Cash Credit Limits in Banks. Mr. A started a website with colorful catchy designs and shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certificate Services". Besides, Mr. A entered in an agreement with a Digital Marketer to give him 5% commission on each service procured through him. Discuss if the actions of Mr. A are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.

**ANSWER:-** As per Clause (6) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients

or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. Mr. A is wrong in seeking clients through family and friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines. In the given situation, Mr. A shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock

Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on website issued by the ICAI. Thus, CA A would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

**QUESTION:-14.** Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. Is Mr. D right in accepting the auditor position?

**ANSWER:-** As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest. Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also.

Therefore, the Council's views are clarified in the following situations. As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company. In the instant case, Mr. D, a practicing CA, is appointed as a Director *Simpliciter* in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. In view of above provisions Mr. D cannot accept the Directorship of the company until the completion of two years after his resignation. Thus, CA D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.

**QUESTION:-15.** Mr. F, a Chartered Accountant, gave advisory services to PQR Pvt. Ltd. Further, he gave them GST consultancy, compilation engagement for historical financial information and helped in ERP set up. Later, the company turned out to be a part of a group of companies involved in money laundering. Mr. F was asked to provide details of the companies. Mr. F refused on the grounds that he gave only consultancy services to the company and wasn't supposed to keep any information about the company. Is Mr. F right as per the guidelines issued by the ICAI?

**ANSWER:-** The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice. In the given situation, CA. F, gave GST consultancy, compilation engagement for historical financial information and helped in ERP set up along with advisory services to PQR Pvt. Ltd. Mr.

F was asked to provide details of the companies as the company, turned out to be a part of a group of companies, involved in money laundering. Content on of Mr. F that he gave only consultancy services and compilation engagement for historical financial information to the company and wasn't supposed to keep any information about the company is not valid as

Mr. F should have kept following information in compliance with KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestations. In the given case of PQR Pvt. Ltd., a Corporate Entity, Mr. F should have kept following information:

A. General Information

- Name and Address of the Entity
- Business Description
- Name of the Parent Company in case of Subsidiary
- Copy of last Audited Financial Statement

B. Engagement Information

- Type of Engagement

C. Regulatory Information

- Company PAN No.
- Company Identification No.
- Directors' Names & Addresses
- Directors' Identification No.

**QUESTION:-16.** Mr. S, the auditor of ABC Pvt. Ltd. has delegated following works to his articles and staff : i. Issue of audit queries during the course of audit. ii. Issue of memorandum of cash verification and other physical verification. iii. Letter forwarding draft observations/financial statements. iv. Issuing acknowledgements for

records produced. v. Signing financial statements of the company. Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

**ANSWER:-** As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements. The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

- (i) Issue of audit queries during the course of audit.
- (ii) Asking for information or issue of questionnaire.
- (iii) Letter forwarding draft observations/financial statements.
- (iv) Initiation and stamping of vouchers and of schedules prepared for the purpose of audit
- (v) Acknowledging and carrying on routine correspondence with clients.
- (vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
- (vii) Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.
- (viii) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
- (ix) Any other matter incidental to the office administration and routine work involved in practice of accountancy
- (x) In the instant case, Mr. S, the auditor of ABC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of

audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company. Therefore, Mr. S is correct in allowing first four tasks i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles. However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, Mr. S is wrong in delegating signing of financial statements to his staff. Conclusion: In view of this, S would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

**QUESTION:-17** Mr. S is a practicing chartered accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper-setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year

20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members).

**ANSWER:- Given situation can be visualised in following parts:**

- (A) Mr. S used to involve himself in equity research and used to advise his friends, relatives and other known people: As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation. In the given case, though Mr. S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr. S shall not make him guilty of professional misconduct.
- (B) **Mr. S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities:** As per Clause 11 of Part I of First Schedule of Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include: -

- Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination. –
- Owning agricultural land and carrying out agricultural activities. Therefore, in the given case, the activities of Mr. S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct.

(C) **Mr. S was discharged insolvent: Disabilities for the Purpose of Membership** : Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period. In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council. In the given case, it is clearly stated that Mr. S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. S has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.